Supreme Court, U.S.
FILED

No. 97-

971679 APR 14 1998

OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

UNUM CORPORATION and
UNUM LIFE INSURANCE COMPANY OF AMERICA,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

---

PETITION FOR A WRIT OF CERTIORARI

BARBARA H. FUREY
BARRY W. LARMAN
UNUM CORPORATION and
UNUM LIFE INSURANCE
COMPANY OF AMERICA
2211 Congress Street
Portland, ME 04122
(207) 770-2211

JOHN G. ROBERTS, JR.*
GREGORY G. GARRE
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, DC 20004
(202) 637-5810

WILLIAM J. KAYATTA, JR.
JARED S. DES ROSIERS
PIERCE ATWOOD
One Monument Square
Portland, ME 04101
(207) 791-1100

* Counsel of Record

Counsel for Petitioners

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

127 pp

QUESTION PRESENTED

Whether distributions made to policyholders as part of the demutualization of a mutual life insurance company are deductible "policyholder dividends" under Subchapter L of the Internal Revenue Code, the part of the Code that deals specifically with the taxation of life insurance companies, or instead nondeductible capital distributions under Subchapter C of the Code, the part that deals generally with the taxation of corporations.

The First Circuit below held that such distributions are nondeductible under Subchapter C, resulting in a $77 million tax burden on the petitioner life insurance company. That ruling conflicts with the plain meaning of the statutory definition of the term "policyholder dividend," prior interpretations of that term by other federal circuits and the government, and established principles of statutory construction applied by this Court.

RULE 29.6 STATEMENT

Petitioner UNUM Corporation is the parent company of petitioner UNUM Life Insurance Company of America. UNUM Corporation has two nonwholly owned subsidiaries, Boston Compania Argentina de Seguros S.A. and UNUM Delaware Company. UNUM Life Insurance Company of America has one nonwholly owned subsidiary, SP Administrator, LLC.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
RULE 29.6 STATEMENT	ii
TABLE OF AUTHORITIES	v
OPINIONS BELOW	1
JURISDICTION	1
STATUTORY AND REGULATORY PROVISIONS INVOLVED	2
INTRODUCTION	2
STATEMENT OF THE CASE	3
REASONS FOR GRANTING THE WRIT	11
I. THE QUESTION PRESENTED IS OF UNDENIABLE IMPORTANCE BOTH TO MUTUAL LIFE INSURERS AND TO THE PUBLIC FISC	11
II. THE FIRST CIRCUIT DECISION CONFLICTS WITH THE PLAIN MEANING OF THE STATUTE, AND WITH THE PLAIN MEANING INTERPRETATION OF THE TERM "POLICYHOLDER DIVIDEND" BY OTHER FEDERAL CIRCUITS	13
III. THE FIRST CIRCUIT DECISION CONFLICTS WITH THIS COURT'S OWN PRECEDENTS AND WITH SETTLED NORMS OF STATUTORY CONSTRUCTION	19
CONCLUSION	29

TABLE OF CONTENTS—Continued

APPENDICES Page

Appendix A: Opinion of the Court of Appeals for the First Circuit, filed December 2, 1997 ..... 1a

Appendix B: Opinion of the District Court, filed May 23, 1996 ..... 38a

Appendix C: Judgment of the Court of Appeals for the First Circuit, dated December 2, 1997 ..... 61a

Appendix D: Order granting extension of time to file petition for certiorari, filed February 5, 1998 ..... 62a

Appendix E: Pertinent statutory and regulatory provisions 63a

TABLE OF AUTHORITIES

Cases: Page

American Nat'l Ins. Co. v. *United States*, 690 F.2d 878 (Ct. Cl. 1982) 15, 21, 22
Bennett v. *Spear*, 117 S. Ct. 1154 (1997) 17
Colonial American Life Ins. Co. v. *Commissioner*, 491 U.S. 244 (1989) 10
Commissioner v. *Engle*, 464 U.S. 206 (1984) 20, 26
Commissioner v. *Lincoln Sav. & Loan Ass'n*, 403 U.S. 345 (1971) 12
Commissioner v. *Estate of Noel*, 380 U.S. 678 (1965) 12
Commissioner v. *Schleier*, 515 U.S. 323 (1995) 20
Connecticut Nat'l Bank v. *Germain*, 503 U.S. 249 (1992) 20
Davis v. *Michigan Dep't of Treasury*, 489 U.S. 803 (1989) 25
Deal v. *United States*, 508 U.S. 129 (1993) 25
Edmond v. *United States*, 117 S. Ct. 1573 (1997) 22
Estate of Cowart v. *Nicklos Drilling Co.*, 505 U.S. 469 (1992) 19
Estate of Swan v. *Commissioner*, 247 F.2d 144 (2d Cir. 1957) 20
HCSC-Laundry v. *United States*, 450 U.S. 1 (1981) 23
Helvering v. *Oregon Mut. Life Ins. Co.*, 311 U.S. 267 (1940) 23
Indianapolis Life Ins. Co. & Subsidiary v. *United States*, 940 F. Supp. 1370 (S.D. Ind. 1996), *aff'd*, 115 F.3d 430 (7th Cir. 1997) 6, 7
INDOPCO, Inc. v. *Commissioner*, 503 U.S. 79 (1992) 20, 21
Jett v. *Dallas Independent School Dist.*, 491 U.S. 701 (1989) 23
King v. *St. Vincent's Hosp.*, 502 U.S. 215 (1991) 25
Lincoln Nat'l Life Ins. Co. v. *United States*, 582 F.2d 579 (Ct. Cl. 1978) 27
Meyer v. *United States*, 375 U.S. 233 (1963) 12
Modern Am. Life Ins. Co. v. *Commissioner*, 92 T.C. 1230 (1989) 14

TABLE OF AUTHORITIES—Continued

	Page
Morales v. *Trans World Airlines, Inc.*, 504 U.S. 374 (1992)	22
Mutual Fire Ins. Co. v. *United States*, 142 F.2d 344 (3d Cir.), *cert. denied*, 323 U.S. 729 (1944)	28
O'Gilvie v. *United States*, 117 S. Ct. 452 (1996)	26
Order of Ry. Employees v. *Commissioner*, 2 T.C. 607 (1943), *appeal dismissed*, 143 F.2d 597 (9th Cir. 1944)	28
Penn Mut. Life Ins. Co. v. *Lederer*, 252 U.S. 523 (1920)	4, 27
Prairie States Life Ins. Co. v. *United States*, 828 F.2d 1222 (8th Cir. 1987)	14, 15
Republic Nat'l Life Ins. Co. v. *United States*, 594 F.2d 530 (5th Cir. 1979)	*passim*
Ruocco v. *Bateman, Eichler, Hill, Richards, Inc.*, 903 F.2d 1232 (9th Cir.), *cert. denied*, 498 U.S. 899 (1990)	14
Salinas v. *United States*, 118 S. Ct. 469 (1997)	17
Thor Power Tool Co. v. *Commissioner*, 439 U.S. 522 (1979)	12
United States v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76 (1960)	12
United States v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132 (1989)	12
United States v. *Korpan*, 354 U.S. 271 (1957)	12
United States v. *Ron Pair Enters.*, 489 U.S. 235 (1989)	20
United States v. *Stapf*, 375 U.S. 118 (1963)	12
United States v. *Wiltberger*, 18 U.S. (5 Wheat.) 76 (1820)	20

Statutes:

26 U.S.C. § 1 *et seq.*	2
26 U.S.C. § 72(e)	12
26 U.S.C. § 118(a)	5
26 U.S.C. § 316	23
26 U.S.C. § 316(b)	7, 24
26 U.S.C. § 803(a)(1)	6
26 U.S.C. § 805	9

TABLE OF AUTHORITIES—Continued

	Page
26 U.S.C. § 805(a) (3)	6
24 U.S.C. § 805(a) (5)	9
26 U.S.C. § 808	*passim*
26 U.S.C. § 808(a)	*passim*
26 U.S.C. § 808(b)	*passim*
26 U.S.C. § 808(b) (1)	*passim*
26 U.S.C. § 809	6, 9, 16
26 U.S.C. § 809(c) (1)	15
26 U.S.C. § 809(f) (4)	6, 9, 27
26 U.S.C. § 811(a) (1959)	15
26 U.S.C. § 1032(a)	5
28 U.S.C. § 1254(1)	2
Deficit Reduction Act of 1984, Pub. No. 98-369, 98 Stat. 494	6, 16
Life Insurance Company Income Tax Act of 1959, Pub. L. No. 86-69, 73 Stat. 112	14, 26
Legislative Materials:	
S. Rep. No. 86-291 (1959)	15
H.R. Rep. No. 98-432 (1984)	17
H.R. Rep. No. 86-34 (1959)	27
105 Cong. Rec. 2571 (1959) (statement of Sen. Curtis)	26
Rules:	
S. Ct. Rule 10(a)	18, 19
S. Ct. Rule 10(c)	28
Regulatory Materials:	
Treasury Regulation § 1.811-2(a) (1961)	15
Treasury Regulation § 601.201(*l*)	8
Dep't of the Treasury, *Final Report to the Congress on Life Insurance Company Taxation*	17
Internal Revenue Service, Tech. Adv. Mem. 8409003 (Nov. 4, 1983)	17
Internal Revenue Service, Tech. Adv. Mem. 9010003 (Nov. 13, 1989)	18
Internal Revenue Service, Priv. Ltr. Rul. 87-11-121 (Dec. 16, 1986)	8

TABLE OF AUTHORITIES—Continued

Other Authorities: Page

Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* (6th ed. 1994) 23

Robert C. Clark, *The Federal Income Taxation of Financial Intermediaries*, 84 Yale L.J. 1603 (1975) 23

Edward X. Clinton, *The Rights of Policyholders in an Insurance Demutualization*, 41 Drake L. Rev. 657 (1992) 4

Wolcott B. Dunham *et al.*, *Demutualization of Life Insurers*, 648 Prac. L. Inst. 9 (1993) 4

Federal Income Taxation of Life Insurance Companies (1997) 4, 18

Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527 (1947) 16

Mark H. Kovey *et al.*, *DRA Introduces New Concepts in Altering Taxation of Life Insurance Companies*, 63 J. Tax'n 48 (1985) 7, 17, 27

S. Preston Ricardo, *The Deductibility of Policyholder Dividends:* UNUM Corp. *v.* United States, 50 Tax Law. 265 (1996) 3,5, 12, 22

Leslie Scism, *Prudential's Plan to Go Public Reflects Industry Trend: More Mutual Life Insurers Need to Seek Outside Capital to Stay Competitive*, Wall St. J., Feb. 18, 1998 5

Leslie Scism, *Prudential to Move to Stock Ownership: Conversion From Mutual Insurer Would be Biggest Ever*, Wall St. J., Feb. 13, 1998..... 5

Leslie Scism, *Wily Investors Seek IPO Score in Their Own Life Insurance*, Wall St. J., Mar. 24, 1998 5

Summaries of Today's Important Tax Items, Tax Notes Today (Aug. 21, 1995) 12

Webster's New International Dictionary of the English Language (2d ed. unabridged 1957) 25

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

No. 97———

UNUM CORPORATION and
UNUM LIFE INSURANCE COMPANY OF AMERICA,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

---

PETITION FOR A WRIT OF CERTIORARI

UNUM Corporation and UNUM Life Insurance Company of America (collectively, "UNUM") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 130 F.3d 501 and reprinted in the appendix hereto ("App.") at 1a. The opinion of the District Court for the District of Maine is reported at 929 F. Supp. 15 and reprinted at App. 38a.

JURISDICTION

The judgment of the Court of Appeals was entered on December 2, 1997. App. 1a. On February 5, 1998, Jus-

tice Souter entered an order extending the time to petition for certiorari to and including April 16, 1998. *Id.* 62a. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Pertinent provisions of the Internal Revenue Code ("Code"), 26 U.S.C. § 1 *et seq.*, are reprinted at App. 63a-89a. Treasury Regulation § 1.811-2(a) (1961) is reprinted at App. 88a.

INTRODUCTION

To stay competitive in the increasingly diversified American financial marketplace, scores of mutual life insurance companies have converted to stock life insurance companies through a process known as "demutualization." Demutualization has become "increasingly common" in the insurance industry, because it enables life insurance companies to enjoy the advantages of stock companies, including enhanced ability to raise capital by selling stock. App. 3a-4a. A characteristic feature of this transaction is the conversion of policyholders' ownership interests in the mutual company into stock in the new company, or cash in lieu of stock. Petitioners in this case underwent such a demutualization in 1986, resulting in the distribution to policyholders of some $652 million in stock and cash.

The question presented is whether, for federal tax purposes, such policyholder distributions are deductible "policyholder dividends" under the terms of Subchapter L of the Code, the part that deals specifically with the taxation of life insurance companies, or instead nondeductible capital distributions under Subchapter C, the part that deals generally with the taxation of corporations. As the Court of Appeals recognized below, this question has "great financial consequences," not only for insurance companies, but for the "public fisc" at large. App. 2a. The tax bar

has recognized that this action is a "landmark case," likely "to affect the course of many mutuals." S. Preston Ricardo, *The Deductibility of Policyholder Dividends:* UNUM Corp. *v.* United States, 50 Tax Law. 265 (1996) (internal quotation marks omitted). The Nation's largest life insurance company has just announced its intention to demutualize, prompting industry analysts to project that still more demutualizations will follow.

Despite its undeniable importance, the answer to the question presented is subject to conflict and confusion. The Internal Revenue Service ("IRS") initially took the position that distributions made to policyholders during such a demutualization are deductible policyholder dividends, but later flipped its position. *See* App. 12a n.6. While acknowledging that UNUM's position was "plausible," the First Circuit below held that such distributions are nondeductible capital distributions, not policyholder dividends. *Id.* 20a. That ruling conflicts not only with the plain meaning of the statutory definition of the term "policyholder dividend," but with the interpretation of that term by other federal circuits, which have held that Congress intended the term "policyholder dividend" to be given its "expansive," natural meaning. *Republic Nat'l Life Ins. Co.* v. *United States*, 594 F.2d 530, 532 (5th Cir. 1979). To reach its conclusion, the First Circuit disregarded the basic tenets of statutory construction established by this Court's own precedents.

This Court should grant certiorari to resolve the conflict and confusion on the undeniably important question presented.

STATEMENT OF THE CASE

1a. There are two types of life insurance companies. The oldest is the mutual life insurance company, owned by the insurer's policyholders, who share a common equitable ownership interest in the company.[1] Mutual insurers

[1] The first mutual insurer in America, the Philadelphia Contributionship for Insurance of Houses from Loss by Fire, is said to have been created by Benjamin Franklin in 1752.

raise capital by charging "redundant premiums"—*i.e.*, premiums in excess of the amount anticipated to be necessary to pay policy benefits and operating expenses. The "redundant" portion of such premiums is accumulated, retained, and invested as "surplus," and eventually returned to policyholders in whole or part. The other type of life insurance company is the stock life insurance company, organized and owned by stockholders, who may or may not be policyholders. Stock insurers—like other stock companies—raise capital by selling stock. *See Federal Income Taxation of Life Insurance Companies* 4.01 to 4.02 (1997); *Penn Mutual Life Ins. Co.* v. *Lederer*, 252 U.S. 523, 525 (1920).

"Mutual insurance companies have historically lagged behind stock insurers in growth of assets and capital," because stock insurers enjoy greater flexibility in raising capital and, thus, are better positioned to compete in the increasingly diversified financial services marketplace. App. 5a. Stock insurers are better able to raise capital because —rather than having to raise premiums that are already subject to comprehensive state regulation—they can simply sell stock on the equity markets. Stock insurers also are able "more easily [to] diversify their operations by creating upstream holding companies which can own subsidiaries engaged in other businesses," and are able to "create incentives for superior management performance through stock option plans." *Id.* 4a. *See* Wolcott B. Dunham *et al., Demutualization of Life Insurers*, 648 Prac. L. Inst. 9 (1993); Edward X. Clinton, *The Rights of Policyholders in an Insurance Demutualization*, 41 Drake L. Rev. 657, 666-674 (1992).

In light of the financial advantages of stock ownership, many mutual life insurance companies have elected to demutualize and reorganize as stock life insurance companies. A characteristic feature of this demutualization process is the conversion of policyholders' ownership interests in the mutual company—including the ownership interest in any accumulated surplus from the collection of

redundant premiums—into shares in the new stock company, or cash made available to policyholders in lieu of stock. Such demutualizations have become "increasingly common" in the insurance industry, as mutual insurers seek to ensure that they have the "financial strength and flexibility" necessary to compete in the "increasingly competitive and deregulated financial services markets." App. 1a, 5a. *See Deductibility of Policyholder Dividends*, *supra*, at 266-267.[2]

b. The federal tax code accounts for the different manner in which capital flows through mutual life insurance companies and stock companies. Generally speaking, capital contributions to stock companies are *not* treated as income, 26 U.S.C. § 118(a); stock companies do *not* recognize gain or loss on the receipt of money or other property in exchange for stock, *id.* § 1032(a); and, thus, stock companies may *not* deduct such contributions (or earnings thereon) when they are returned to stockholders in

---

[2] The Nation's largest life insurance company, Prudential Insurance Company of America, with some $260 billion in assets and $20 billion in net worth, recently announced its intention to demutualize for precisely this reason. *See* Leslie Scism, *Prudential's Plan to Go Public Reflects Industry Trend: More Mutual Life Insurers Need to Seek Outside Capital to Stay Competitive*, Wall St. J., Feb. 18, 1998, at B4. This decision prompted one industry leader to predict that "all major mutual life insurers [will] announce plans for some form of public ownership over the next three years." *Id.* (internal quotation marks omitted). *See also* Leslie Scism, *Prudential to Move to Stock Ownership: Conversion From Mutual Insurer Would be Biggest Ever*, Wall St. J., Feb. 13, 1998, at A3 (Prudential's "move * * * reflects drastic change sweeping the life insurance industry," which is "concerned about keeping pace in the rapidly consolidating financial-services world"). Indeed, "[i]n recent months," several major mutual insurers—in addition to Prudential—have either announced plans to demutualize or taken actions in that direction, including Mutual Insurance of New York and Principle Mutual Life Insurance Co. *See* Leslie Scism, *Wily Investors Seek IPO Score in Their Own Life Insurance*, Wall St. J., Mar. 24, 1998, at C1.

the form of dividends or the like. These rules are spelled out in Subchapter C of the Code, the part that deals generally with the taxation of corporations. Mutual life insurance companies, on the other hand, *are* taxed on the equivalent of such capital contributions—*i.e.*, redundant premiums—when received, and, accordingly, *are* permitted to deduct such amounts when they are returned to policyholders in the form of dividends or the like. *See* 26 U.S.C. §§ 805(a)(3), 808-809. These rules are in Subchapter L of the Code, the part that deals specifically with the taxation of life insurance companies.

Section 803(a)(1) of Subchapter L includes "premiums" in the definition of "life insurance gross income." *Id.* § 803(a)(1). Section 805(a)(3) establishes a deduction for "policyholder dividends," *id.* § 805(a)(3), which Section 808(a), in turn, defines as "any dividend or similar distribution to policyholders in their capacity as such," *id.* § 808(a), and which Section 808(b) specifically provides includes "any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *," *id.* § 808(b)(1). Section 809 establishes a different formula for calculating the policyholder dividends deduction available to mutual life insurance companies, as opposed to stock companies. Subsection 809(f)(4) specifies how a mutual life insurance company should calculate its policyholder dividends deduction for any year in which it demutualizes into a stock insurer, indicating that Congress contemplated that the policyholder dividend deduction would be available in that situation. *See id.* § 809(f)(4).[3]

---

[3] Section 809 was the product of a long-standing dispute between stock and mutual insurers over the proper manner of calculating the policyholder dividends deduction for mutual insurers, which was resolved in the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 ("1984 Act"). *See Indianapolis Life Ins. Co. &*

The separate schemes established by the federal tax code for the taxation of capital flowing through corporations in general, in Subchapter C, and insurance companies in particular, in Subchapter L, overlap in the following important respect: in Subchapter C, Congress specifically directed that "[t]he definition [of a taxable dividend under Subchapter C] * * * shall *not* apply to the term 'dividend' as used in subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such." 26 U.S.C. § 316(b) (emphasis added). In other words, Congress not only established an entirely different scheme in Subchapter L for taxing policyholder distributions—in order to take into account the different manner in which capital flows through mutual insurance companies—but it specifically indicated again in Subchapter C that distributions made to insurance policyholders shall be treated differently.

2a. This case arises out of the demutualization of UNUM, a Maine-based company that has been in the life insurance business since 1848. From 1848 to 1986, UNUM operated as a mutual life insurance company called Union Mutual Life Insurance Company ("Union Mutual"). As a mutual insurer, the company had no stock and, in order to raise capital, charged its policyholders redundant premiums, which the company accumulated, retained, and invested as "surplus." From 1959 to 1986, the company's total accumulated surplus grew from approximately $9 million to $652 million, as measured by generally accepted accounting principles. In 1984 Union Mu-

---

Subsidiary v. *United States*, 940 F. Supp. 1370, 1372 (S.D. Ind. 1996), *aff'd*, 115 F.3d 430 (7th Cir. 1997); Mark H. Kovey *et al.*, *DRA Introduces New Concepts in Altering Taxation of Life Insurance Companies*, 63 J. Tax'n 48 (1985). While the 1984 Act altered the formula for calculating the amount of the deduction, it left in place the expansive definition of "policyholder dividend" now found in Section 808(a)—*i.e.*, "*any* dividend or similar distribution to policyholders in their capacity as such." 26 U.S.C. § 808(a) (emphasis added).

tual decided to demutualize and reorganize as a stock life insurance company. App. 5a, 8a n.4.

After obtaining the approval of state regulatory authorities as well as its own policyholders, Union Mutual executed a plan of conversion in 1986. The plan terminated the membership interests of eligible policyholders in exchange for either stock in a holding company (UNUM Corporation) or cash in lieu of stock. At the conclusion of this process, UNUM Corporation, the holding company, was owned by former policyholders, various insiders, and the public, and it, in turn, owned UNUM Life Insurance Company. All told, approximately $652 million—the amount that Union Mutual had accumulated in surplus from the collection of redundant premiums and earnings thereon—was distributed in cash and stock to eligible policyholders. The amount paid to policyholders was not fixed in their insurance contracts, but rather was based on a formula drawn by the company for the demutualization based on its experience, and varied on an individual policyholder basis. *Id.* 8a-11a, 39a-43a.

b. In its federal tax return for the 1986 tax year, UNUM initially took a conservative approach and did not claim a deduction for the $652 million in policyholder distributions made during the demutualization.[4] Pursuant to an agreement it had entered into with the IRS, however, UNUM later amended its 1986 return and—based on further analysis of the federal tax consequences of demutualization—claimed that the stock and cash distributions were

---

[4] Prior to the demutualization, Union Mutual asked for a private letter ruling from the IRS, addressing certain tax issues related to the demutualization. The IRS, in turn, asked Union Mutual for its view on whether the resulting cash distributions would be deductible "policyholder dividends." Union Mutual answered in the affirmative, but the IRS took the contrary position. *See* App. 10a-12a; Priv. Ltr. Rul. 87-11-121 (Dec. 16, 1986). By regulation, however, this ruling was not binding on either UNUM or the government. *See* Treas. Reg. § 601.201(*l*).

deductible "policyholder dividends" under Sections 805 and 808 of Subchapter L of the Code.[5] Taking these deductions into account, UNUM's amended return for 1986 sought a refund of $77 million. The IRS refused to recognize the claimed deductions on the ground that policyholder distributions made as part of a demutualization are capital distributions governed by the general corporate tax provisions in Subchapter C—not Subchapter L—and, accordingly, denied UNUM's refund request. App. 12a-13a.

3a. In 1993 UNUM brought this action in the United States District Court for the District of Maine, seeking a ruling that it is entitled to a policyholder dividends deduction and the resulting refund. The District Court initially denied the government's motion for summary judgment, but then ruled for the government on a stipulated record. *See id.* 38a. The court framed the "dispositive issue" as whether distributions made to policyholders during a demutualization "fall within the definition of 'policyholder dividend' contained in I.R.C. § 808 and are, therefore, deductible under I.R.C. § 805(a)(5)." App. 45a-46a. In answering that question, the court rejected UNUM's plain meaning construction of Section 808 on the ground that the definition of the term "policyholder dividend" must be construed "strictly," *id.* 47a—*i.e.*, not literally. Then, applying its "strict[]" construction, the court held that the distributions at issue are not "policyholder dividends," because, while "the distribution amounts are not fixed in the contract," they are not sufficiently "dividend-like" to qualify for the deduction. *Id.* 59a (internal quotation marks omitted).

b. UNUM filed a timely appeal and the First Circuit affirmed. The Court of Appeals acknowledged that

---

[5] It is undisputed that, in claiming this deduction, UNUM fully complied with Section 809 of the Code, including the special rule in Section 809(f)(4) governing calculation of the deduction when the insurer demutualizes. *See* 26 U.S.C. § 809(f)(4).

UNUM's plain meaning construction of Section 808 was both "colorable" and "plausible," *id.* 13a, 20a, but nevertheless felt obliged to reject it under the "rule of *Colonial American*," which—according to the Court of Appeals—provides that the "general corporate tax provisions of Subchapter C apply to insurance companies unless Subchapter L makes a specific provision to the contrary." *Id.* 16a. The First Circuit derived this "rule" from *Colonial American Life Insurance Co.* v. *Commissioner*, 491 U.S. 244 (1989), a case that—up to that point—had received scant attention from the parties and had been ignored completely by the District Court, and which does not even mention Subchapter C (or any of its provisions). Applying this "rule," the Court of Appeals held that the specific provision set forth in Subchapter L authorizing life insurance companies to deduct "policyholder dividends" from gross income does not cover distributions made during a demutualization, because "nothing in § 808 * * * specifically overrides th[e] general rules" found in Subchapter C. App. 25a.

In rejecting UNUM's plain meaning interpretation, the First Circuit acknowledged that other federal circuits had interpreted the term "policyholder dividend" "expansive-[ly]"—giving effect to the plain meaning of the broadly worded statutory definition—in order to account for Congress' " 'inten[t] to include *more* than just classic dividends' within policyholder dividends." *Id.* 27a n.13 (quoting *Republic Nat'l Life Ins. Co.*, 594 F.2d at 532) (emphasis added); *accord id.* 19a. But the First Circuit dismissed that approach, and held instead that "[a]ny distribution by an insurer to its policyholders must * * * bear the essential characteristics of a [corporate] dividend * * * in order to qualify as a 'policyholder dividend.' " App. 26a. The Court of Appeals also declined to give any weight to the "broad scope" of the Treasury Department's interpretation of the term "policyholder dividend." *See id.* 19a.

c. On February 5, 1998, Justice Souter entered an order extending the time to petition for certiorari to and including April 16, 1998. *Id.* 62a.

REASONS FOR GRANTING THE WRIT

I. THE QUESTION PRESENTED IS OF UNDENIABLE IMPORTANCE BOTH TO MUTUAL LIFE INSURERS AND TO THE PUBLIC FISC.

As the Court of Appeals acknowledged below, the question whether distributions made to policyholders as part of a demutualization are deductible "policyholder dividends" has "great financial consequences" not only for mutual insurers, but for the "public fisc." *Id.* 2a. The size of the claimed policyholder dividends deduction in this case alone is $652 million, which translates into a $77 million tax burden if the deduction is denied.[6] Because demutualizations have become "increasingly common" in the insurance industry—and, as recent developments indicate, are likely to become even more prevalent, *see* note 2, *supra*—the availability of the policyholder dividends deduction in these circumstances could easily have a several billion dollar impact on mutual insurers (and their policyholders) through the close of this century alone.[7] It is not surprising to find, then, that this action

[6] Seventy-seven million dollars is the amount of the tax refund UNUM was owed as of 1988, assuming distributions made to policyholders as part of a demutualization are deductible "policyholder dividends." But as of 1988, UNUM had not claimed as deductions all of the distributions made during the demutualization; it carried forward more than $480 million in such deductions, which—if the plain import of the statutory scheme is given effect—could result in additional tax refunds in future years. In other words, much more than $77 million is actually at stake in this case alone.

[7] This is not to say that giving effect to the plain meaning of the policyholder dividends deduction would result in a several billion dollar loss of tax revenue to the government. Demutualizations by their nature generate huge amounts of tax revenues. Policyholder dividends, unlike amounts paid in redemption of stock, are taxable to

already has been recognized as a " 'landmark case,' " " 'expected to affect the course of many mutuals.' " *Deductibility of Policyholder Dividends, supra,* at 265 (quoting *Summaries of Today's Important Tax Items,* Tax Notes Today (Aug. 21, 1995)).

The undeniable importance of the question presented both to mutual insurers and to the government, as well as to the administration of the federal tax laws, alone warrants granting the writ. *See, e.g., United States* v. *Goodyear Tire & Rubber Co.,* 493 U.S. 132, 138 (1989) (certiorari granted because "Court of Appeals' decision has important consequences for the calculation of the indirect tax credit" available to certain companies); *Thor Power Tool Co.* v. *Commissioner,* 439 U.S. 522, 525 (1979) ("certiorari [granted] to consider these important and recurring income tax accounting issues"); *Commissioner* v. *Lincoln Sav. & Loan Ass'n,* 403 U.S. 345, 346-347 (1971) ("Because of the importance of [federal tax] issue for the savings and loan industry and for the Government, we granted certiorari."); *Commissioner* v. *Estate of Noel,* 380 U.S. 678, 680 (1965) ("Because of the importance of an authoritative answer to these questions in the administration of the [federal] tax laws, we granted certiorari to decide them"); *Meyer* v. *United States,* 325 U.S. 233, 234 (1963) ("We granted certiorari because of the importance of the question in the administration of the income tax laws."); *accord United States* v. *Stapf,* 375 U.S. 118, 120 (1963); *United States* v. *Cannelton Sewer Pipe Co.,* 364 U.S. 76, 78 (1960); *United States* v. *Korpan,* 354 U.S. 271, 273 (1957).

---

the policyholder as ordinary income to the extent such distributions exceed the policyholder's investment in the insurance contract. *See* 26 U.S.C. § 72(e). In addition, as the value of the new stock company increases following the demutualization, sales and resales of the converted company's stock generate ongoing revenue that would not have been realized if the company had remained a mutual insurer.

The question presented, however, is not only one of great consequence; it is one on which conflict and confusion exist.

II. THE FIRST CIRCUIT DECISION CONFLICTS WITH THE PLAIN MEANING OF THE STATUTE, AND WITH THE PLAIN MEANING INTERPRETATION OF THE TERM "POLICYHOLDER DIVIDEND" BY OTHER FEDERAL CIRCUITS.

1. Section 808 of Subchapter L of the Internal Revenue Code defines the term "policyholder dividend" in plain and unambiguous terms. A "policyholder dividend" is "any dividend or similar distribution to policyholders in their capacity as such." 26 U.S.C. § 808(a). Section 808(b) then specifies that "policyholder dividend * * * includes * * * any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *." *Id.* § 808(b)(1). This definition is straightforward and, when applied to the facts that the distributions in this case (1) were made to UNUM's policyholders as such, (2) were not fixed by contract, and (3) were calculated based on the past experience of UNUM in collecting and investing premiums and meeting the costs of insurance and operations, *see* App. 6a-10a; C.A. App. 248, 252, 256, 335, 339, 377-386, 417, 514, 612, 591-593, results in the inexorable conclusion that the distributions are policyholder dividends within the meaning of Section 808 and, thus, deductible pursuant to Section 805(a)(3).

2. This conclusion squares with the plain meaning interpretation of the term "policyholder dividend" adopted by other federal circuits. For example, in *Republic National Life Insurance Co.* v. *United States*, 594 F.2d at 532 (emphasis added), the Fifth Circuit stated that Subchapter L's definition of "policyholder dividend" is "expansive," and was plainly "intended to include *more* than

just classic dividends." *See also id.* at 536 (congressional "debates reflect an understanding that 'dividend' as used in the insurance industry is a term of art which means almost *any* payment not derived solely from premium income") (district court decision adopted by Fifth Circuit in relevant part) (emphasis added). *See also Prairie States Life Ins. Co.* v. *United States*, 828 F.2d 1222, 1226 (8th Cir. 1987) (Subchapter L's "unambiguous and straightforward" statutory scheme "essentially treats all distributions to policyholders" as a return of redundant premiums, or policyholder dividends); *Modern Am. Life Ins. Co.* v. *Commissioner*, 92 T.C. 1230, 1243 (1989) ("Congress was aware that 'dividend' as used in the insurance industry is a term of art which means almost *any* payment not derived from premium income.") (internal quotation marks omitted; emphasis added).[8]

These cases involved the taxation scheme established by the Life Insurance Company Income Tax Act of 1959 ("1959 Act"), Pub. L. No. 86-69, 73 Stat. 112, which is codified in Subchapter L of the Code. Under the 1959 Act, amounts refunded to policyholders were divided into two categories: "return premiums," which were deductible in whole, and "policyholder dividends," which were de-

---

[8] The First Circuit decision below is also at odds with *Ruocco* v. *Bateman, Eichler, Hill, Richards, Inc.*, 903 F.2d 1232 (9th Cir.), *cert. denied*, 498 U.S. 899 (1990). *Ruocco* arose out of the same demutualization underlying this case. The plaintiffs were employees who participated in a long-term disability plan offered by the defendant employer (BEHR). The plan's long-term disability carrier was UNUM. When UNUM demutualized, BEHR received some $500,000 in policyholder distributions. The employees claimed that BEHR had violated ERISA and various state law duties by failing to redistribute the distributions to plan participants. *Id.* at 1234-35. Among other things, BEHR argued that it was entitled to retain the surplus under a provision of California insurance law that permits an employer of insureds to retain policyholder "dividend[s]." *Id.* at 1236 (quoting statute). In pertinent part, the Ninth Circuit held that "the distribution of the surplus constitutes a *dividend* under the [statute]." *Id.* at 1237 (emphasis added).

ductible in part. *See American Nat'l Ins. Co.* v. *United States*, 690 F.2d 878, 882 (Ct. Cl. 1982). The touchstone for distinguishing between these two categories was whether the amount was fixed by contract. Thus, the 1959 Act defined "policyholder dividends" as "dividends and similar distributions to policyholders in their capacity as such," 26 U.S.C. § 811(a) (1959), then provided that "amounts returned where the amount is *not* fixed in the contract but depends on the experience of the company or the discretion of management shall not be included in return premiums," *id.* § 809(c)(1) (emphasis added). In other words, under the 1959 Act, amounts that were not fixed in the contract but instead depended on the experience of the company or the discretion of management were policyholder dividends. *See Prairie States Life Ins. Co.*, 828 F.2d at 1225; S. Rep. No. 86-291, at 813 (1959).

In 1961 the Treasury Department issued a formal regulation underscoring the breadth of the term "policyholder dividend" under this scheme. It provided in pertinent part:

> Section 811(a) defines the term "dividends to policyholders" * * * to mean dividends and similar distributions to policyholders in their capacity as such. The term includes amounts returned to policyholders where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management. In general, *any* payment not fixed in the contract * * * shall be treated as a dividend to policyholders. Similarly, *any* amount refunded or allowed as a rate credit * * * shall be treated as a dividend to policyholders if such amount depends on the experience of the company. [Treas. Reg. § 1.811-2(a) (1961) (emphasis added).]

3. In litigation arising under the 1959 Act the government took the position that the term "policyholder dividend" should be broadly construed, consistent with the plain meaning of the broadly worded statute and 1961 Treasury Regulation. *See, e.g., Republic Nat'l Life Ins.*

Co., 594 F.2d at 532. Under the scheme established by the 1959 Act, that position was generally favorable to the government, since policyholder dividends were only deductible in part, whereas the other alternative—return premiums—were deductible in their entirety. As noted, courts of appeals adopted this plain—and "expansive"—interpretation of the term. *Id.* *See supra* at 13-14.

In 1984 Congress passed new legislation that altered the formula established by the 1959 Act for calculating the amount of the policyholder dividends deduction, *see* 26 U.S.C. § 809, but, at the same time, cemented the expansive definition of the term "policyholder dividends." *See* Deficit Reduction Act of 1984 ("1984 Act"), Pub. L. No. 98-369, 98 Stat. 494. Congress underscored the breadth of the term "policyholder dividend" in two important respects: first, it added the word "any" prior to "dividend or similar distribution" in Section 808(a), 26 U.S.C. § 808(a); and second, it codified the interpretation in the 1961 Treasury Regulation, adding the proviso in Section 808(b) that the term " 'policyholder dividend' * * * includes * * * any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *." *Id.* § 808(b)(1).

These amendments are telling. As Justice Frankfurter has explained, when a concept "is obviously transplanted from another legal source, * * * it brings the old soil with it." Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 537 (1947). Here, the government had adopted the 1961 Treasury Regulation to ensure that the term "policyholder dividend" would be construed broadly, in accordance with its broad terms; the courts accepted the government's expansive reading of that term; and, in the 1984 Act, Congress explicitly codified that understanding. The language Congress chose—"*any* dividend or similar distribution" and "*any* amount * * * not fixed in the contract," 26 U.S.C. § 808(a), (b)—

was aptly suited to its purpose. *See Salinas* v. *United States*, 118 S. Ct. 469, 473 (1997) ("The word 'any' * * * undercuts the attempt to impose [a] narrowing construction."); *Bennett* v. *Spear*, 117 S. Ct. 1154, 1162 (1997) (phrase "any person," though of "remarkable breadth," should be taken at "face value").

But while the 1984 Congress cemented the broad definition of what constitutes a "policyholder dividend" within the meaning of Subchapter L, it changed the deductibility rules so that the expansive definition was now more favorable to the *taxpayer*.[9] This policy change—which Congress adopted in order to "level the playing field" between stock and mutual insurers, Kovey *et al.*, *supra*, at 48—apparently caused the government to reconsider its interpretation. Not long after the 1984 Act became law, the government abandoned its prior interpretation of the term "policyholder dividend" and took the position that the same language it had said should receive an expansive interpretation should now be narrowly construed.

This abrupt about-face is vividly illustrated by the IRS' flip-flop on the precise question presented by this case. In 1983 the IRS took the position—advanced by UNUM in this case—that cash distributions made to policyholders during the demutualization of a mutual casualty insurer through a merger with a stock insurer were "policyholder dividends." IRS Tech. Adv. Mem. 8409003 (Nov. 4, 1983) ("The distribution to Mutual's policyholders upon

---

[9] Generally speaking, whereas the 1959 Act imposed a ceiling on the amount of policyholder dividends an insurer was permitted to deduct, the 1984 Act permits unlimited deductions of policyholder dividends, subject to the condition that the deduction for such dividends declared by any mutual insurer in any year would be reduced in accordance with a formula based on the relative industry-wide rates of return of mutual and stock life insurers as computed annually by the Treasury Department. *See* C.A. App. 665 (Dep't of the Treasury, *Final Report to the Congress on Life Insurance Company Taxation* 25 n.8) (explaining how Section 809 works); H.R. Rep. No. 98-432, at 1422-26 (1984) (same).

merger into taxpayer was a policyholder dividend."). In 1989, however, the IRS summarily "revoked" that position. IRS Tech. Adv. Mem. 9010003 (Nov. 13, 1989). *See* App. 12a n.6 (acknowledging change in IRS position on "the tax treatment of distributions from surplus made during a demutualization"); *Federal Income Taxation of Life Insurance Companies*, *supra*, § 8.02[3], at 8-67 n.156.2 (same).[10]

The government's inconsistent and transparently result-oriented position on the reach of the term "policyholder dividend" exacerbates the uncertainty that shrouds the question presented. The fact that the government has now succeeded in convincing different courts of appeals to adopt its conflicting positions makes this uncertainty especially problematic, and calls for this Court's review. *See* S. Ct. Rule 10(a).

4. The First Circuit in this case acknowledged that other federal circuits have held "that 'policyholder dividends' have an 'expansive definition' and 'include *more* than just classic dividends,' " App. 19a (quoting *Republic Nat'l Life Ins. Co.*, 594 F.2d at 532) (emphasis added), and observed that UNUM's plain meaning interpretation was both "plausible" and "colorable." App. 13a, 20a. But, at the government's urging, the court rejected that interpretation and refused to conclude that the distributions at issue fit within the statutory definition of the term "policyholder dividend." Thus, according to the First Circuit, the "mere fact that 'policyholder dividends' are not 'fixed' by the terms of an insurance contract does not mean that they include any distribution that a mutual insurer makes to its policyholders in any capacity." *Id.* 35a-36a. Instead, the Court of Appeals held, a more searching

---

[10] Technical advice memoranda are not binding on the IRS, but the IRS' about-face on the question presented in the 1983 and 1989 memoranda cited above is nevertheless illustrative of the inconsistent positions that the government has taken on the important question presented by this case.

inquiry was required to determine whether the distribution at issue is "fundamentally" like a " 'dividend or similar distribution,' " when viewed from the perspective of a classic corporate dividend taxable pursuant to Subchapter C. *Id.* 28a, 36a.

That approach conflicts with the plain meaning of the broadly worded definition of the term "policyholder dividends," and with the plain meaning interpretation of that term by other federal circuits. Indeed, whereas other circuits have held that "policyholder dividends" was "intended to include *more* than just classic dividends," *Republic Nat'l Life Ins. Co.*, 594 F.2d at 532 (emphasis added), the First Circuit below concluded that the term is "subject to the constraints which *limit* the classic definition of dividends." App. 18a (emphasis added). *See id.* 26a (Section 808 "requires all 'policyholder dividends' to possess the essential characteristics of a dividend"). As a result, mutual insurers doing business in the First Circuit may no longer obtain the full benefit of the policyholder dividends deduction that Congress established in order to ensure the fair tax treatment of capital contributions flowing through mutual and stock insurers.

That conflict—over the meaning of an important provision of the federal tax code—should be resolved by this Court. *See* S. Ct. Rule 10(a). As explained next, however, it is not the only conflict presented by this case, because the *manner* in which the First Circuit reached that interpretation directly conflicts with this Court's own precedents and, more particularly, the settled norms of statutory construction this Court has applied in construing the federal tax code and other statutes.

III. THE FIRST CIRCUIT DECISION CONFLICTS WITH THIS COURT'S OWN PRECEDENTS AND WITH SETTLED NORMS OF STATUTORY CONSTRUCTION.

1. The first rule of statutory construction is of course that the statute's plain meaning should be given effect. *See Estate of Cowart* v. *Nicklos Drilling Co.*, 505 U.S.

469, 475 (1992) (when "a statute speaks with clarity to an issue judicial inquiry into the statute's meaning, in all but the most extraordinary circumstance, is finished"); *United States* v. *Ron Pair Enters.*, 489 U.S. 235, 242 (1989) ("The plain meaning of legislation should be conclusive, except in the rare cases in which the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.") (quotation and brackets omitted); *Commissioner* v. *Engle*, 464 U.S. 206, 214 (1984) (starting point is "the language of the statute itself"); *United States* v. *Wiltberger*, 18 U.S. (5 Wheat.) 76, 95-96 (1820) (Marshall, C.J.) ("Where there is no ambiguity in the words, there is no room for construction."). In this case, application of that rule leads to the conclusion that the distributions at issue are "policyholder dividends" within the meaning of Section 808; the sheer breadth of the statutory definition permits no other conclusion. *See supra* at 13.

The First Circuit below, like the District Court before it, immediately sought to circumvent that plain meaning by invoking the canon that "[d]eductions must * * * be 'strictly construed.' " App. 17a (quoting *INDOPCO, Inc.* v. *Commissioner*, 503 U.S. 79, 84 (1992)). *See also* App. 47a (District Court). That canon, however, is only a "default rule of statutory interpretation." *Commissioner* v. *Schleier*, 515 U.S. 323, 327 (1995) (internal quotation marks omitted). It does not trump the rule that the statute's plain meaning controls when, as here, the statute is unambiguous. *See Estate of Swan* v. *Commissioner*, 247 F.2d 144, 148 (2d Cir. 1957) ("although as a general rule exemptions and deductions are to be strictly construed, that general rule of construction must bow to clear statutory language and policy"); *see also Connecticut Nat'l Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992) ("[C]anons of construction are no more than rules of thumb that help courts determine the meaning of legislation, and in interpreting a statute a court should always turn first to one, cardinal canon before all others. * * *

[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there.").

Thus, even when "strictly construed," a deduction is allowed when there "is clear provision therefor." *INDOPCO, Inc.*, 503 U.S. at 84 (internal quotation marks omitted). Section 808 is such a "clear provision" in the case of policyholder dividends; under the first rule of statutory construction, then, the First Circuit was required to give effect to that provision.

2. To avoid this conclusion, the First Circuit also trumpeted what it referred to as "the rule of *Colonial American*," under which, the Court of Appeals held, the "general corporate tax provisions of Subchapter C apply to insurance companies unless Subchapter L makes a specific provision to the contrary." App. 16a. The court drew this "rule" from this Court's decision in *Colonial American Life Insurance Co.* v. *Commissioner, supra,* a case which had received little more than passing reference from the parties and was tellingly ignored by the District Court. *Colonial American* not only does not purport to erect the blanket rule of statutory construction articulated by the First Circuit below, but is plainly distinguishable from this case, which of course accounts for the scant attention it received up to the point of the First Circuit decision. Indeed, contrary to the panel's apparent misunderstanding, *Colonial American* does not even mention Subchapter C (or any of its provisions), let alone purport to "address[] the relationship between Subchapter C and Subchapter L." App. 16a (First Circuit decision).

The question in *Colonial American* was whether ceding commissions paid by a reinsurance company to a direct insurer under an indemnity reinsurance contract may be taken as current deductions or, instead, must be amortized over the life of the reinsurance agreements. The taxpayer argued that the ceding commissions were analogous to agents' commissions and expenses, which are deductible

under Section 809 of Subchapter L. The government argued that the commissions were analogous to capital expenditures required to be amortized under Section 263 of the Code (which is not found in Subchapter C). Because it agreed with the government's analogy, the Court held that the ceding commissions must be amortized "absent some specific statutory provision indicating" that they were subject to different tax treatment. 491 U.S. at 253. The taxpayer argued that such a provision existed in Subchapter L, but the Court disagreed. *See id.* at 260.

This case, unlike *Colonial American*, does not require the Court to draw far-reaching analogies in order to determine whether the amounts at issue are taxable under Subchapter L or another section of the Code. Rather, it simply requires the Court to read the statute and determine whether the amounts at issue fit within the statutory definition of "policyholder dividend." This is because, in this case, unlike *Colonial American*, there *is* a "specific statutory provision" directly on point—Section 808 of Subchapter L. *Colonial American* provides no basis for the Court to disregard that specific provision under the guise of looking to the general *corporate* provisions in Subchapter C, which, as noted, were not even implicated by *Colonial American*. *See Deductibility of Policyholder Dividends*, *supra*, at 276 ("Section 808 of Subchapter L * * * expressly provides that distributions of property made by an insurance company to its policyholders as such shall be treated under its provisions, *removing analysis of the distribution from Subchapter C.*") (emphasis added).

More fundamentally, the First Circuit's reading of *Colonial American* turns on its head the settled maxim of statutory construction that the specific overrides the general. *See Edmond* v. *United States*, 117 S. Ct. 1573, 1578 (1997) ("Ordinarily, where a specific provision conflicts with a general one, the specific governs."); *Morales* v. *Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992) ("it is a commonplace of statutory construction that the

specific governs the general"); *HCSC-Laundry* v. *United States*, 450 U.S. 1, 6 (1981) ("it is a basic principle of statutory construction that a specific statute * * * controls over a general provision"); *Jett* v. *Dallas Independent School Dist.*, 491 U.S. 701, 738-739 (1989) (Scalia, J., concurring in part and concurring in judgment) ("rudimentary principles of construction [hold] that the specific governs the general").

As a leading treatise puts it, "Subchapter L contains intricate and specialized provisions for the taxation of life insurance companies." Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 1.06 (6th ed. 1994). *See also* Robert C. Clark, *The Federal Income Taxation of Financial Intermediaries*, 84 Yale L.J. 1603, 1637 (1974) (discussing the Code's "special tax provisions applicable to life insurance companies"). Subchapter C, by contrast, governs the taxation of corporations in general. *See Helvering* v. *Oregon Mut. Life Ins. Co.*, 311 U.S. 267, 268-269 (1940) (since 1921 life insurance companies have been "wholly exempted * * * from the general scheme of corporation taxation" established by the Internal Revenue Code, and have been subject to "special systems [of taxation] applicable to them alone"). Both subchapters define and establish rules governing the taxation of dividends or similar distributions. *Compare* 26 U.S.C. § 316 (defining corporate dividends in general) *with* § 808 (defining policyholder dividends in particular).

Under the time-honored rule that the specific overrides the general, the specific policyholder dividend provision in Subchapter L trumps the general corporate dividend provision in Subchapter C. The First Circuit below, however, turned that rule on its head, and decided the important question presented based on the principle that the "general corporate tax provisions of Subchapter C apply to insurance companies unless Subchapter L makes a specific provision to the contrary." App. 16a. That skewed

perspective placed an inappropriate burden on UNUM in attempting to establish that it is entitled to the claimed deduction and, more important, led the Court of Appeals to misconstrue the clear intent of Congress in Section 808 to treat the type of distributions at issue in this case as deductible policyholder dividends.[11]

Congress, in any event, eliminated any room for argument on this important point. It included in the Code a specific statutory provision expressly providing that the general rules in Subchapter C do *not* apply in this instance. Section 316(b) of the Code specifies that the definition of a dividend in Subchapter C "shall *not* apply to the term 'dividend' as used in subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such." 26 U.S.C. § 316(b) (emphasis added). This specific provision is found in Subchapter C rather than L, but surely that is not significant in applying the so-called "rule" of *Colonial American*. Invoking general corporate dividend principles to construe Subchapter L's specific "policyholder dividend" provision is thus directly contrary not only to the rule that the specific trumps the general, but also to Congress' express direction in Section 316(b).

---

[11] In another, perhaps even more inexplicable misapplication of the canon that the specific overrides the general, the First Circuit refused to construe the general definition of "policyholder dividends" in Section 808(a) in light of the specific direction in Section 808(b) that "policyholder dividend * * * *includes* * * * any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *." 26 U.S.C. § 808(b)(1) (emphasis added). *See* App. 25a-26a. Thus, under the First Circuit construction, even if a distribution is a "policyholder dividend" under a plain reading of Section 808(b), it will not be a "policyholder dividend" within the meaning of Section 808(a) unless it meets the First Circuit *a priori* requirement—not found in the text or plain meaning of the statute—that the distribution "possess the essential characteristics of a dividend" taxable under Subchapter C. *Id.* 26a.

3. The First Circuit interpretation also conflicts with this Court's precedents emphasizing that "the meaning of a word * * * must be drawn from the *context* in which it is used." *Deal* v. *United States*, 508 U.S. 129, 132 (1993) (emphasis added). *See King* v. *St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991) ("[T]he meaning of statutory language, plain or not, depends on context."); *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803, 809 (1989) ("It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.").

In construing the term "policyholder dividend," the Court of Appeals, like the District Court before it, looked to general corporate law principles and ultimately held that, to qualify as a "policyholder dividend," a "distribution * * * must * * * bear the essential characteristics of a [corporate] dividend." App. 26a. Looking to the characteristics of general corporate dividends taxable under Subchapter C of the Code to define the term "policyholder dividend" in Subchapter L, however, is a bit like looking to Roger Tory Peterson's *Field Guide to Eastern Birds* to define the term "eagle" in the game of golf. When the term "policyholder dividend" is viewed from the *context* in which Congress drafted it, it takes on an entirely different meaning from the one the First Circuit assigned to it.

Indeed, that much is clear from the separate dictionary definition of the term "dividend"—as that term is used in the *insurance* context—which existed when Congress first adopted the term "policyholder dividend" in the 1959 Act. *See Webster's New International Dictionary of the English Language* 195 (2d ed. unabridged 1957) ("A share of surplus allocated to a policyholder in a participating insurance policy, which generally represents a return of a portion of the premium not needed to meet losses and expenses, and a distribution of earnings from investment."). The principal drafter of the statutory definition

of the term "policyholder dividend" now codified in Section 808(a) made that clear, too, when he explained at the time of the passage of the 1959 Act that "the word 'dividend' in life insurance companies has a different connotation than we would use in the investment field." 105 Cong. Rec. 2571 (1959) (statement of Sen. Curtis). *See also Republic Nat'l Life Ins. Co.*, 594 F.2d at 536 (congressional "debates reflect an understanding that 'dividend' as used in the insurance industry is a term of art which means almost any payment not derived solely from premium income") (quoting district court decision).

4. Finally, the First Circuit interpretation conflicts with the canon—which this Court has emphasized in construing the Internal Revenue Code—that a court should remain "faithful to the history of the statutory provision as well as the basic tax-related purpose that the history reveals." *O'Gilvie* v. *United States*, 117 S. Ct. 452, 455 (1996). *See also Commissioner* v. *Engle*, 464 U.S. at 217 (court should examine Code provision in the context of its history and purpose in order to "find that interpretation which can most fairly be said to be imbedded in the statute, in the sense of being most harmonious with its scheme and with the general purposes that Congress manifested.") (internal quotation marks omitted).

The 1959 Act was enacted in large measure because of Congress' recognition of the different manner in which capital flows through mutual companies as opposed to stock companies, and its concern that mutual insurance companies were being unfairly treated by a tax code that failed to take that difference adequately into account. As the Fifth Circuit put it:

> Congress recognized that the deduction for dividends to policyholders would benefit the mutual companies who wrote participating policies. In fact, one of Congress's principal areas of concern when it enacted the 1959 Act was the relative tax burdens of the mutual and stock companies. Congress further recognized

> that the tax treatment of dividends would in large measure determine the tax distribution between mutual and stock companies. [*Republic Nat'l Life Ins. Co.*, 594 F.2d at 533 (citing H.R. Rep. No. 86-34, at 5 (1959)).]

In 1984 Congress amended Subchapter L in an effort to further "level the playing field" between stock and mutual insurers. Kovey *et al.*, *supra*, at 48. In doing so, Congress expressly confirmed the expansive reach of the term "policyholder dividend," adding "any" to the general definition in Section 808(a) and adding the more specific proviso in Section 808(b) that "policyholder dividend * * * includes * * * any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *." 26 U.S.C. § 808(b)(1). It also eliminated the ceiling on the deductibility of policyholder dividends, *see id.* § 808; note 3, *supra*, and adopted a "special rule" for determining the amount of the policyholder dividend deduction in any year in which a mutual insurer undergoes a demutualization, *see* 26 U.S.C. § 809(f)(4)—indicating that Congress was well aware of the natural application of the policyholder dividend deduction to distributions made as part of a demutualization.

The First Circuit ruling flies in the face of the history and purpose of the policyholder dividends deduction, disrupting the careful balance Congress sought to achieve between the tax treatment of mutual insurers and stock companies in enacting and then amending the pertinent provisions of Subchapter L. Indeed, "[i]t is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder." *Penn Mut. Life Ins. Co.*, 252 U.S. at 525. *See Lincoln Nat'l Life Ins. Co.* v. *United States*, 582 F.2d 579, 593-594 n.9 (Ct. Cl. 1978). The purpose of the policyholder dividends deduction is to ensure that mutual insurers are permitted to deduct "*any*" such "dividends or

similar distributions" when made. 26 U.S.C. § 808(a) (emphasis added). Nothing in Subchapter L, or its history or purpose, suggests that the policyholder dividends deduction is unavailable simply because the distributions are made as part of a demutualization.[12] Section 809(f)(4) alone is evidence to the contrary. But there is no need to reach that level of specificity. A plain reading of the statute compels the conclusion that the policyholder dividends deduction is available in these circumstances.

Especially in view of the undeniable importance of the question presented, the clear conflict between the First Circuit decision and this Court's own precedents establishing the rules governing the construction of federal statutes provides an independent reason for granting the writ. *See* S. Ct. Rule 10(c).

---

[12] The fact that the policyholder dividends in this case were paid upon dissolution of the mutual insurer should not alter this conclusion. *See Mutual Fire Ins. Co.* v. *United States*, 142 F.2d 344, 349 (3d Cir.) ("In a true mutual insurance company the members * * * are entitled to receive its net assets upon dissolution."), *cert. denied*, 323 U.S. 729 (1944); *Order of Ry. Employees* v. *Commissioner*, 2 T.C. 607, 615 (1943) (mutual insureds, "and they alone, are entitled to dividends, whether resulting from current operations or paid upon dissolution"), *appeal dismissed*, 143 F.2d 597 (9th Cir. 1944).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

BARBARA H. FUREY
BARRY W. LARMAN
UNUM CORPORATION and
UNUM LIFE INSURANCE
COMPANY OF AMERICA
2211 Congress Street
Portland, ME 04122
(207) 770-2211

JOHN G. ROBERTS, JR.*
GREGORY G. GARRE
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, DC 20004
(202) 637-5810

WILLIAM J. KAYATTA, JR.
JARED S. DES ROSIERS
PIERCE ATWOOD
One Monument Square
Portland, ME 04101
(207) 791-1100
Counsel for Petitioners

* Counsel of Record

APPENDIX A

UNITED STATES COURT OF APPEALS
FIRST CIRCUIT

No. 96-1877

UNUM CORPORATION and UNUM LIFE INSURANCE COMPANY OF AMERICA,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

Heard Sept. 9, 1997
Decided Dec. 2, 1997

Before TORRUELLA, Chief Judge, ALDRICH, Senior Circuit Judge, and LYNCH, Circuit Judge.

LYNCH, Circuit Judge.

The need to raise capital and to compete in increasingly diversified financial markets has led a number of American mutual life insurance companies to convert to being stock companies. This process, known as "demutualization," often involves a conversion of the mutual policyholders' ownership interest in the old company into ownership interest in the form of stock in the new company.

This appeal raises important questions about the proper tax treatment of one form of demutualization: whether

stock and cash distributed to policyholders in exchange for their mutual ownership interests as part of a statutory demutualization constitute "policyholder dividends" under § 808 of the Internal Revenue Code. If so, the insurer may take a deduction for "policyholder dividends" under § 805(a)(3). Whether the "policyholder dividends" deduction is available has great financial consequences for the company and for the public fisc. This question involves consideration of the scope of the "policyholder dividend" under § 808, as well as the broader relationship between the general corporate tax provisions of the Code (contained in Subchapter C) and the Code's insurance tax provisions (contained in Subchapter L).

In this case, UNUM Corp. ("UNUM"), the demutualized successor to Union Mutual Life Insurance Co. ("Union Mutual"), seeks a tax refund based on a "policyholder dividends" deduction of over $652 million. This sum, which UNUM was required to distribute to its policyholders by state law, represents the value of Union Mutual's accumulated surplus. *See* Me.Rev.Stat. Ann. tit. 24-A, § 3477 (West 1996).

UNUM's principal argument is that the cash and stock distributed during the demutualization constitute "policyholder dividends" under the plain language of § 808(b) and thus are deductible under § 805. UNUM further argues that, beyond the statute's plain language, the legislative history and public policy behind the Code's treatment of life insurance companies support this result.

The IRS argues that general corporate tax provisions apply to insurance companies in the absence of specific provisions to the contrary in the Code's insurance tax section, and that, under those corporate tax provisions, UNUM is not entitled to any deduction for its reorganization. The IRS argues that nothing in § 808 or its legislative history indicates that Congress envisioned § 808 as encompassing capital transactions such as UNUM's de-

mutualization. Rather, placed in proper context, § 808 is not relevant to the value-for-value exchanges for which UNUM seeks a deduction.

The district court entered judgment for the government in UNUM's suit for a refund. We affirm the judgment of the district court.

I

This appeal involves only questions of law; we exercise *de novo* review. *Alexander v. Internal Revenue Service,* 72 F.3d 938, 941 (1st Cir.1995). The parties have agreed on the facts.

A. *Background*

Demutualization has become increasingly common in the insurance industry. More than 200 mutual life insurance companies have demutualized since 1930. *See* S. Preston Ricardo, *The Deductibility of Policyholder Dividends: UNUM Corp. v. United States,* 50 Tax Law. 265, 265 (1996). Between 1954 and 1981, the number of mutual insurers declined from 171 to 135; during the same time, the number of stock insurers increased from 661 to 1,823. Edward X. Clinton, *The Rights of Policyholders in an Insurance Demutualization,* 41 Drake L.Rev. 657, 659 n.13 (1992). Today, fewer than 80 mutual insurers have assets of over $100 million. *See* William B. Dunham, Jr., et al., *Introduction, in Demutualization of Life Insurers,* 648 PLI/Comm 9, 16 (1993). These figures suggest that mutual insurers are rapidly demutualizing, and that new insurance companies prefer the stock form at the outset.

State legislatures have facilitated this demutualization process by passing statutes permitting such conversions. Presently, at least forty-one states have specific statutes that provide for demutualization of mutual life insurers. Alexander M. Dye, *Distributing Consideration to Policy-*

holders, in Demutualization of Life Insurers, 648 PLI/ Comm 75, 78 (1993). Only Hawaii and Idaho expressly prohibit direct mutual to stock conversion, although they still permit demutualization through the alternate method of bulk reinsurance conversion. *See* Clinton, *supra,* at 673 n.116. Every state, including those that lack specific demutualization statutes, permits at least some form of demutualization. *See id.*

There are three usual types of mutual to stock conversions: a statutory conversion whereby the insurer directly converts its form of business, merger with a stock insurer, and bulk reinsurance of the mutual company's policies. *See id.* at 660-61. This case only concerns the first type of conversion: a statutory conversion, in which a mutual company alters its organizational form to become a stock insurer by redistributing all the mutual policyholder's ownership interest in the mutual insurer into shares of stock in a new stock corporation. "This type of reorganization may properly be regarded as a reorganization of the company because the policyholders are exchanging membership in the mutual for shares in the new corporation." *Id.* at 660.

By demutualizing, mutual insurers can obtain certain advantages available to stock insurers. Stock corporations are better able to raise capital because they may sell stock on the equity markets. *See id.* at 666-671. Stock companies can more easily diversify their operations by creating upstream holding companies which can own subsidiaries engaged in other businesses. *See id.* at 671-72. They can also create incentives for superior management performance through stock option plans. *See id.* at 672-74. Mutual insurers can only raise capital by retaining earnings or charging excess premiums, and are generally subject to comprehensive regulation by state authorities. These limitations can hinder their ability to grow and diversify. *See id.* at 666.

Much is at stake in this process. Mutual insurance companies have historically lagged behind stock insurers in growth of assets and capital. Demutualization and subsequent stock sales may improve a mutual insurer's capital position and competitive standing with other insurers and financial institutions. Mutual insurers naturally want to contend in the increasingly competitive and deregulated financial services markets. Many mutual insurers regard demutualization as an important step toward bolstering their financial strength and flexibility.

B. *Facts*

Union Mutual, based in Maine, was organized as a mutual insurance company in 1848. Union Mutual's business was selling various types of insurance and annuity products. As a mutual company, Union Mutual had no stock and was owned by its participating policyholders.[1] Policyholders contributed to Union Mutual's surplus by paying premiums that exceeded the actuarial cost of their policy coverage.

In 1984, Union Mutual's management decided to reorganize the company as a stock insurer. The manage-

---

[1] Mutual life insurance companies do not raise money by issuing capital stock, but rather by charging policyholders a "redundant premium" that exceeds the amount actuarially anticipated to pay the policy's benefits and expenses. The excess portions of these premiums are accumulated, retained, and invested as "surplus".

A mutual insurer's accumulated surplus is the excess of assets over liabilities. Such an excess results from the accumulation of redundant premiums and investment earnings over the life of the company. Surplus generally belongs to the mutual insurer's members in proportion to their contributions, and is generally returned to policyholders through policyholder dividends.

Mutual insurers are thus owned by their policyholders. Policyholders in mutual companies are denominated "members" of the company; their ownership rights in the company are their "membership interests". Members of mutual insurance companies have many of the same rights as stockholders in corporations, including the right to vote and the right to residual surplus upon liquidation.

ment decided that the company would gain four principal business advantages from this conversion: an increased ability to raise capital, greater flexibility to diversify into new markets, an increased accountability for company performance by management, and an enhanced ability to attract and retain key personnel.

Under Maine law, Union Mutual was not permitted to implement its conversion plan until the plan was approved by the Maine Superintendent of Insurance. *See* Me.Rev. Stat. Ann. tit. 24-A, § 3477 (West 1996). Maine law imposes several conditions that a demutualization plan must satisfy in order to receive approval by the Superintendent. These include, *inter alia,* (1) that the company pay policyholders a "fair and equitable" amount for their ownership interests in the company, (2) that the "equity share" of each policyholder be determined under a fair and reasonable formula based upon the insurer's entire surplus as stated in a financial statement filed with the Superintendent, (3) that the conversion plan give each member of the demutualizing insurer a preemptive right to acquire his or her proportionate part of the proposed capital stock of the new stock company, (4) that the plan provide for payment to each member of his or her entire equity share in the insurer, with the payment to be made in cash or stock of the stock company, and (5) that policyholders entitled to receive stock or cash include all policyholders within three years prior to the date the plan was submitted for approval to the Superintendent. *See id.*

On December 14, 1984, Union Mutual submitted a plan of recapitalization and conversion to the Superintendent. Union Mutual amended the plan several times in response to rulings by the Superintendent. On July 11, 1986, Union Mutual submitted its fourth and final amended plan, which was approved by the Superintendent on August 8, 1986.

The approved plan of conversion may be generally described as follows. A holding company was formed to own all the stock of the new stock company. Those who were "eligible policyholders" [2] transferred their "membership interests" in Union Mutual to the holding company in exchange for stock in the holding company. "Membership interests" were defined in the conversion plan as:

> [A]ll the rights or interests of each policy and contract holder of Union Mutual including, but not limited to, any right to vote, any rights which may exist with regard to the surplus of Union Mutual not apportioned by the Board for policyholder dividends, and any rights in liquidation or reorganization of Union Mutual, but shall not include any other right expressly conferred by a policyholder's insurance policy or contract.

Eligible policyholders who qualified as "cash option eligible policyholders" [3] could elect to exchange their membership interests for cash instead of stock. The holding company, after obtaining 100% of the membership interests in Union Mutual, exchanged the membership interests for 100% of the shares of the newly formed stock insurer. The holding company sold stock not issued to policyholders to insiders and the general public. At the conclusion of the Plan, UNUM Life Insurance Co. ("UNUM Life"), the new stock company, was a wholly owned subsidiary of UNUM, the holding company. UNUM was in turn owned by former Union Mutual policyholders, insiders, and members of the general public.

---

[2] "Eligible policyholders" were generally defined in the conversion plan as all Union Mutual policyholders during the three years prior to December 31, 1984.

[3] "Cash option eligible policyholders" were generally defined in the conversion plan as policyholders with equity of less than $2,500 in Union Mutual.

The approved plan included an actuarial formula for calculating the consideration to be paid to each policyholder in exchange for his or her membership interest in Union Mutual. This figure, denominated each policyholder's "equity share" in Union Mutual, was defined as "the dollar amount of that part of Union Mutual's Adjusted Surplus attributable to" the particular policyholder. Each policyholder's "equity share" comprised two components: a "minimum equity share" and the individual's "contribution to statutory surplus". On December 31, 1985, the day Union Mutual presented its consolidated balance sheet for final review by the Superintendent, Union Mutual's adjusted surplus was $652,050,097.[4] Based on that figure, Union Mutual's management determined that each policyholder should receive a per capita amount of $612.25 as the "minimum equity share". The "contribution to statutory surplus" varied by individual policyholder. The formula for computing a policyholder's "equity share" that is referred to in the plan of conversion reveals this two-component scheme.

The plan of conversion also provided for creation of an accounting mechanism known as a Participation Fund Account ("PFA"). The PFA created the functional

---

[4] Surplus can be measured by either statutory accounting principles or generally accepted accounting principles ("GAAP"). The difference between the two methods is primarily one of timing: the costs of selling policies are fully charged when incurred under statutory accounting principles, but are amortized over the expected life of the policies under GAAP. UNUM's accumulated surplus of $652,050,097 was calculated under GAAP.

In UNUM's demutualization plan, "surplus" was defined as "the amount of the surplus of Union Mutual as shown by its financial statement as of the Computation Record Date (December 31, 1985) filed with the Superintendent, as may be confirmed or adjusted in the event of an examination by the Superintendent, including all voluntary reserves but without taking into account the value of nonadmitted assets or of insurance business in force."

equivalent of a closed block[5] and was allocated assets which, together with premiums from the participating policies, were actuarially sufficient to pay policy claims and policyholders dividends. Under the conversion plan, the amount of the assets in the PFA could not be distributed to stockholders of the demutualized insurer. As with a closed block, it had to be invested and used for the exclusive benefit of the policyholders. The PFA was designed with the aim that Union Mutual's policyholders would continue to receive policyholder dividends after the demutualization at the same level as before, even though policyholders and stockbrokers would have competing claims on the earning and profits of the company. The PFA thus was meant to assure policyholders that their reasonable expectations about the investment value of their policies would continue to be met.

The creation of the PFA was an important consideration in the Superintendent's decision to approve the demutualization plan. In his Final Decision and Order, the Superintendent discussed the PFA at some length, observing that Union Mutual policyholders had bought their policies with an understanding that policy costs would be

---

[5] Some states protect the policyholders by requiring that a mutual insurer establish a "closed block" of business as a condition of demutualization. *See* N.Y. Ins. Laws. § 7312 (West 1997); 40 Pa. Cons.Stat. Ann. § 915-A (West 1997). Such statutes generally require the mutual insurer's policies and contracts in force at the time of the reorganization be placed by the reorganized insurer into a "closed block" into which the insurer must allocate assets that, together with revenue, are sufficient to pay policy claims and policyholder dividends. Thereafter, the insurer may not distribute any earnings or proceeds developed within that block to stockholders. The closed block must be operated for the exclusive benefit of the included policies and contracts, distributions being for policyholder dividend purposes only. *See id.*; Dye, *supra* at 115-116.

A PFA may be required as a condition of demutualization in states which do not require a closed block. The Maine demutualization statute does not require a closed block. *See* Me.Rev. Stat. Ann. tit. 24-A, § 3477 (West 1996).

continually adjusted through dividends reflecting Union Mutual's actual experience. The Superintendent also noted that, when purchasing their policies, policyholders based their dividend expectations on dividend illustrations shown to them by Union Mutual that were in turn based on the dividends the company had been paying pursuant to the dividend scales current at the time of purchase. The Superintendent concluded:

> Even though these "illustrations" were not guarantees that dividends would be paid, Union Mutual, in practice, typically paid dividends in accordance with these scales. Based upon these illustrations and upon actual practice, policyholders expect that they will continue to receive these dividends as long as their policies are in force. Therefore, I find it appropriate that the Plan, by creating a mechanism such as the PFA, supports these expectations of future dividends.

That the PFA would maintain these expectations was, according to the Superintendent, critical to the acceptability of the conversion plan.

Union Mutual implemented its plan of conversion on November 14, 1986. To the 105,098 Eligible Policyholders who selected the Cash Option, Union Mutual distributed $129,129,082. To the remaining 58,561 Eligible Policyholders, Union Mutual distributed 20,489,072 shares of UNUM stock. This stock was assessed as having a fair market value of $25.20 per share, making the total value of the UNUM stock distributed under the Plan equal to $522,471,336. Union Mutual also distributed an additional $609,396 in cash to compensate policyholders for the value of fractional shares created by the conversion formula. In total, Union Mutual distributed $652,209,8174 to the Eligible Policyholders during the demutualization.

Prior to the demutualization, on October 12, 1984, Union Mutual's tax counsel had asked the IRS for a pri-

vate letter ruling on the tax treatment of the conversion. Contrary to the position taken by UNUM now, Union Mutual then sought to convince the IRS that the stock distributed to policyholders in exchange for their membership interests in Union Mutual would constitute tax free exchanges under § 351 of the Code. UNUM also sought to persuade the IRS that the exchange of the membership interests received by the holding company for common stock of the new stock company would constitute a tax free recapitalization under § 368(a)(1)(E).

In support of these positions, Union Mutual made a submission to the IRS on March 25, 1985 stating that "the equity interest of Union Mutual's policyholders resemble the rights of stockholders in a corporation and have substantial value." The submission further stated that the Supreme Court, in *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194, 62 S.Ct. 546, 86 L.Ed. 789 (1942), had characterized a recapitalization as a "reshuffling of a capital structure within the framework of an existing corporation," *Id.* at 202, 62 S.Ct. at 552, and argued that "[t]he exchange of *evidences* of ownership interest in Union Mutual argues for the exchange being treated as a recapitalization" under the Supreme Court's characterization. *Id.* (emphasis in original).

Union Mutual made another submission to the IRS on November 8, 1985, discussing whether the exchange of the membership interests for cash or stock would be treated as nondeductible redemptions of stock under § 302 or as deductible "policyholder dividends" under § 808 and § 805, although UNUM did not specifically ask for a letter ruling on that subject at that time.

On December 16, 1986, the IRS issued its private letter ruling to Union Mutual regarding the proper tax treatment of the demutualization. *See* Priv. Ltr. Rul. 87-11-121 (December 16, 1986). The letter ruling stated that the exchange between the policyholders and UNUM

of the policyholders' membership interests in Union Mutual for UNUM stock was a tax-free exchange under § 351. *See id.* The ruling also stated that the exchange between UNUM and UNUM Life, the stock insurer that would succeed Union Mutual, of the Union Mutual membership interests for UNUM Life voting common stock was a tax free recapitalization under § 368(a)(1)(E). *See id.* The ruling further stated that the cash distributed to policyholders in exchange for their membership interests constituted value-for-value transfers and were, accordingly, properly characterized as nondeductible redemptions under § 302, not deductible "policyholder dividends" under § 808 and § 805. *See id.*[6] The IRS viewed the stock-for-membership interest exchanges, in contrast, as non-recognition exchanges subject to § 351 (no gain or loss recognized to policyholders), § 354 (no gain or loss recognized to holding company on exchange of membership interests to converted company for stock), and § 1032 (no gain or loss recognized to either holding company or converted company on receipt of property for stock).

On its 1986 consolidated federal income tax return, UNUM did not claim a "policyholder dividend" deduction for the cash and stock distributed to policyholders during

---

[6] The IRS has not always held this view regarding the tax treatment of distributions from surplus made during a demutualization. In 1983, the IRS issued a non-binding technical advice memorandum addressing the demutualization of a mutual casualty insurer through merger with a stock insurer. Tech. Adv. Mem. 8409003 (Nov. 4, 1983). In this memorandum, the IRS took the view now advanced by UNUM that cash distributions paid out of surplus to policyholders during the demutualization were policyholder dividends under then § 822(e)(2) and § 822(c)(11). In 1989, the IRS withdrew this memorandum without comment. Tech. Adv. Mem. 9010003 (Nov. 13, 1989). Because such memoranda are nonbinding, we do not base our conclusions upon them. We nonetheless recognize that the IRS has not consistently maintained the positions it presently advances in this appeal.

the demutualization. UNUM had entered into an agreement with the IRS extending the time period within which the IRS could audit the 1986 return, after which UNUM would be given an additional six months within which to decide whether to amend the return to claim a refund. The IRS audit, which ended in 1991, concluded that UNUM had properly characterized the cash distributions as non-deductible stock redemptions under § 302 and the stock distributions as made pursuant to nonrecognition exchanges of its stock for property. UNUM thereafter changed its view of the proper tax treatment of the transaction by timely amending its 1986 return to claim the cash ($129,738,748), then the value of the stock ($522,471,336), as deductible policyholder dividends under § 808 and § 805. UNUM sought a refund in excess of $77 million. The IRS denied these claimed deductions.

In 1993, UNUM filed suit in the district court, seeking deductions and a refund of the $77 million. The district court ruled in favor of the government, holding that the cash and stock distributions could not be construed as "policyholder dividends" under § 808. UNUM appeals.

II

UNUM makes a colorable but ultimately unpersuasive argument that this appeal involves only the narrow task of interpreting § 808 and § 805 of the Code. UNUM would have at least a plausible argument that it was entitled to a "policyholder dividend" deduction if those two sections were the only potentially relevant Code sections to this case. But we must construe the Code as a whole. The Supreme Court admonished in *Helvering v. N.Y. Trust Co.*, 292 U.S. 455, 54 S.Ct. 806, 78 L.Ed. 1361 (1934), that "the expounding of a statutory provision strictly according to the letter without regard to other parts of the Act and legislative history [may] often defeat the object intended to be accomplished." *Id.* at 464, 54 S.Ct. at 808-09. Therefore, courts must

> not look merely to a particular clause in which general words may be used, but . . . take in connection with it the whole statute (or statutes on the same subject) and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry into execution the will of the Legislature, as thus ascertained, according to its true intent and meaning.

Id. (citation and internal quotations omitted).

We conclude that § 808 and § 805 do not govern this case. UNUM's demutualization constitutes a capital transaction and is accordingly subject to the general corporate tax rules under Subchapter C which govern such transactions. These rules clearly bar any deduction for amounts distributed during a capital transaction.

A. *Structural Overview*

Because this case involves the interplay between two Subchapters of the Code, we describe them in general terms. Subchapter C is a broadly applicable section of the Code which contains many of the Code's general corporate tax provisions. It applies to all corporations, including mutual and stock insurance companies. *See* § 7701(a)(3) ("When used in this title, . . . [t]he term 'corporation' includes . . . insurance companies."); § 7701 (a)(8) ("the term 'shareholder' includes a member in an . . . insurance company.").

Subchapter C governs corporate capital transactions and the taxation of all corporate distributions and adjustments, including the organization, operation, liquidation, and reorganization of all corporate enterprises and their distributions to shareholders and associates. *See* §§ 301-85. Many general rules in Subchapter C as well as additional

rules in other sections of the Code contain language that, by their literal terms, bar the deduction UNUM seeks. Sections 162, 311, 354, and 1032 apply with particular force. We explain these sections and discuss why they apply later.

Subchapter L, in contrast, is a highly focused section of the Code which specifically governs certain aspects of the taxation of life insurance companies. *See* §§ 801-818. Subchapter L enacts a special scheme of determining the gross income, deductions, and taxable income of life insurance companies, whether of the stock or mutual variety. It accommodates the unique manner by which life insurance companies raise and distribute capital. One purpose behind this parallel system of income calculation is to determine more accurately the taxable income of life insurance companies than general tax rules otherwise would permit.

While Subchapter L applies specifically to life insurance companies, the existence of Subchapter L does not exempt insurance companies from the application of the rest of the Code, Subchapter L at times specifically displaces otherwise applicable rules. For example, life insurance company taxable income is defined in § 801 as "life insurance gross income" reduced by "life insurance deductions". § 801(b). "Life insurance gross income" is specifically defined in § 803, not the generally applicable definition of gross income provided in § 61. And "life insurance deductions" are specifically governed by § 804 and § 805, even though § 804 and § 805 incorporate many of the general rules about deductions by reference. But Subchapter L does not alter general tax rules governing subjects not within its ambit. Specifically, Subchapter L does not exempt insurance companies from the general corporate tax rules of Subchapter C "[e]xcept to the extent that [Subchapter L makes] specific provisions." S.Rep. No. 291, 86th Cong., 1st Sess. 39 (1959), *reprinted in* 1959-2 C.B. 770, 798.

The Supreme Court addressed the relationship between Subchapter C and Subchapter L in *Colonial American Life Ins. Co. v. Commissioner*, 491 U.S. 244, 109 S.Ct. 2408, 105 L.Ed.2d 199 (1989). *Colonial American* involved the question of whether "ceding commissions" paid by a reinsurance company to a direct insurer under an indemnity reinsurance contract could be deducted in the year in which they were paid, or whether they had to be capitalized over the estimated life of the underlying policies. *See id.* at 246-47, 109 S.Ct. at 2411. The taxpayer argued that the ceding commissions were analogous to certain agents' commissions deductible under § 809 and should be similarly deductible. *See id.* at 249-50, 109 S.Ct. at 2412-13. The IRS responded that the ceding commissions were more properly characterized as a type of capital expenditure and should, as is usual for such expenditures, be amortized over their useful life under § 263. *See id.* at 252-53, 109 S.Ct. at 2413-15. The Court ruled against the taxpayer, holding that § 809 did not expressly provide for the requested deduction and that § 263 should apply in the absence of a specific provision to the contrary. *See id.* at 260, 109 S.Ct. at 2418. The taxpayer's argument, the Court stated,

> at most proves only that Congress decided to carve out an exception for agents' commissions, notwithstanding their arguable character as capital expenditures. We would not take it upon ourselves to extend that exception to other capital expenditures, notwithstanding firmly established tax principles requiring capitalization, where Congress has not provided for the extension.

Id. at 252, 109 S.Ct. at 2413-14.

Under the rule of *Colonial American*, general corporate tax provisions of Subchapter C apply to insurance companies unless Subchapter L makes a specific provision to the contrary. The question that this case poses, therefore,

is whether the cash and stock distributions made by UNUM during its conversion are made specifically deductible by § 808 and § 805 of Subchapter L, notwithstanding the fact that they are clearly not deductible under § 162, § 311, § 354, § 1032 and other relevant provisions of the Code.

B. *UNUM's burden of proof*

It is a now "familiar rule" that an income tax deduction " 'is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer.' " *INDOPCO, Inc. v. Commisioner*, 503 U.S. 79, 84, 112 S.Ct. 1039, 1043, 117 L.Ed.2d 226 (1992) (quoting *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593, 63 S.Ct. 1279, 1281-82, 87 L.Ed. 1607 (1943)). Deductions must therefore be "strictly construed" and allowed " 'only as there is clear provision therefor.' " *Id.* (quoting *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440, 54 S.Ct. 788, 790-91, 78 L.Ed 1348 (1934)). Subchapter L has been subject to narrow construction because its provisions "give life insurance companies tax benefits over other taxpayers." *National Life & Accident Ins. Co. v. United States*, 385 F.2d 832, 833 (6th Cir.1967). Thus it is UNUM's burden to demonstrate that the cash and stock distributed during the demutualization constitute deductible "policyholder dividends" under § 808.

C. *Analysis of UNUM's arguments*

UNUM's principal argument is that the cash and stock distributions constitute "policyholder dividends" under the plain meaning of § 808, § 808(b)(1) in particular, and are therefore deductible under § 805(a)(3). Bolstering this position are two overlapping contentions: (1) the legislative history and public policy underlying the Code's scheme of life insurance taxation demonstrate that Congress intended the term "policyholder dividend" to include

the distributions made during UNUM's demutualization; and (2) because "policyholder dividends" are broader than classic corporate dividends, "policyholder dividends" need not possess the essential characteristics of a dividend —i.e., they are not subject to the constraints which limit the classic definition of dividends. We reject both arguments.

There is no dispute that § 805(a)(3) allows life insurance companies to deduct "policyholder dividends" from income. Section 805(a)(3) expressly states: "there shall be allowed the following deductions: . . . —The deduction for policyholder dividends . . ." § 805(a)(3). The real question, rather, is whether the definition of "policyholder dividend" in § 808 encompasses the cash and stock distributed during UNUM's demutualization.

In this regard, UNUM's principal argument is that the plain meaning of § 808 entitles it to deduct the amounts distributed during the demutualization.[7] We believe that, in order to make this claim successfully, UNUM must demonstrate that the distributions satisfy both § 808(a) and § 808(b). Section 808(a) provides that:

> [F]or purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.

---

[7] Section 808(a) and (b) provide in full:

> (a) Policyholder dividend defined.—For purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.
>
> (b) Certain amounts included.—For purposes of this part, the term "policyholder dividend" includes—
>
> (1) any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management.
>
> (2) excess interest,
>
> (3) premium adjustments, and
>
> (4) experience-rated refunds.

§ 808(a). Under § 808(b)(1), upon which UNUM hinges the main body of its argument, a "policyholder dividend" may include:

> any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management.

§ 808(b).

UNUM asserts that the distributions easily satisfy § 808(a), which, UNUM claims, merely emphasizes the broad scope of "policyholder dividends." The source of UNUM's authority for this claim is unclear. UNUM seems to rely principally on *Republic Nat'l Life Ins. Co. v. United States,* 594 F.2d 530 (5th Cir.1979), in which the court stated that "policyholder dividends" have an "expansive definition" and "include more than just classic dividends." *Id.* at 532. UNUM seems also to rely on Treas. Reg. § 1.811-2(a) (1997), which tracks the language of § 808(a), as further evidence of the broad scope of the "policyholder dividend." Because "policyholder dividends" are "expansive", UNUM argues, they necessarily encompass the amounts distributed during the demutualization. We are not persuaded by these arguments, which attempt to sweep the language of § 808(a) under the table. Rather, we think that § 808(a) presents a major obstacle, which UNUM fails to overcome.

UNUM argues that the real test is whether the distributions satisfy § 808(b). UNUM focuses its attention on the text of § 808(b)(1), arguing: (1) Nothing in the insurance contracts between UNUM and its policyholders addressed the amounts due to the policyholders in a demutualization; therefore the amounts were "not fixed in the contract"; (2) The cash was distributed out of Union Mutual's accumulated surplus, which represents the fruits of the company's considerable business success since its

founding; therefore the amounts "depend[ed] on the experience of the company"; (3) Union Mutual's management, though subject to the supervision of the Maine Superintendent of Insurance and obligated to present "fair and equitable" terms to the policyholder, decided the amounts within that range which would be paid to policyholders in exchange for their equity interests; therefore, the amounts were based "on the discretion of management." The combination of these circumstances, UNUM argues, satisfies the elements of § 808(b)(1) and thus the distributions are "policyholder dividends" deductible under § 805(a)(3), regardless of the general corporate tax provisions contained in Subchapter C.

While we recognize that UNUM's argument is plausible, we nonetheless find it unpersuasive. As we explain later, § 808(b) describes categories of distributions that may constitute policyholder dividends provided that the definition of § 808(a) is met. But UNUM has failed to satisfy us that the term "policyholder dividend" under § 808(a) includes value-for-value exchanges that occur during a corporate reorganization such as this. UNUM's argument ultimately suffers from a fundamental defect: it assumes that Congress wished to ignore the context in which the cash and stock distributions took place. We later explain why UNUM's arguments that the distributions fit within § 808(a) fail. We first set the stage as to why Subchapter C applies.

D. *Application of Subchapter C*

In a paradigmatic recapitalization, the corporation is not allowed a deduction for distributions made in the course of the transaction. *See Woodward v. Commissioner*, 397 U.S. 572, 579 n.8, 90 S.Ct. 1302, 1307 n.8, 25 L.Ed.2d 577 (1970) ("[W]herever a capital asset is transferred to a new owner in exchange for value either agreed upon or determined by law to be a fair quid pro

quo, the payment itself is a capital expenditure . . ."); *United States v. Houston Pipeline Co.*, 37 F.3d 224, 226 (5th Cir.1994) ("Stock redemptions, as a general rule, are characterized as capital transactions, and the purchase price of a stock redemption is not deductible.") (footnotes omitted); *Jim Walter Corp. v. United States*, 498 F.2d 631 (5th Cir.1974) (corporation's purchase of outstanding warrants in connection with issuance of stock and bonds treated as a capital transaction); *Frederick Weisman Co. v. Commissioner*, 97 T.C. 563, 572, 1991 WL 241153 (1991) (collecting cases).

Here, Union Mutual purchased its policyholders' equity interests and transferred them to UNUM. UNUM in turn exchanged the policyholders' membership interests in Union Mutual for stock in UNUM or cash. UNUM was financially in no worse a position after "paying out" $522 million worth of stock to implement the demutualization than it was before the transaction occurred. What changed was the form of ownership, precisely the topic which capital transactions typically involve.[8] As for the $130 million distributed in cash to redeem certain policyholders' interests, UNUM was left poorer. But the Code disallows

---

[8] UNUM acknowledged that its demutualization was a capital transaction subject to general corporate tax law when it submitted its May 22, 1985 request to the IRS for a private letter ruling regarding whether the conversion would be entitled to tax-free treatment under § 351 and § 368(a)(1)(E). The IRS treated the demutualization as a capital transaction in its response, *see* Priv. Ltr. Rul. 87-11-121 (Dec. 16, 1986), in which it confirmed that the transaction would be nontaxable under those sections and further stated that the cash distributions would be treated as nondeductible redemptions under § 302 and the stock distributions would be treated as non-recognition exchanges under § 1032. We do not view this as precluding UNUM from changing its position, but that UNUM thought it necessary to ask the IRS for a letter ruling on the general corporate tax implications of its demutualization reflects UNUM's awareness that its restructuring was subject to Subchapter C.

deductions for such distributions made in redemption. *See* § 311(a).

We find that, because UNUM's demutualization is a capital transaction, it is subject to the general corporate tax provisions of Subchapter C unless UNUM carries its burden of showing an exception. These provisions clearly prohibit a company from deducting cash or the value of stock distributed to its policyholders in redemption of their equity interests in the company.

Applying Subchapter C, the Code would clearly disallow UNUM from taking a deduction on the *cash* distributed during the demutualization. Section 311 provides that a corporation that purchases shares of its stock from a shareholder ordinarily may not receive a deduction for that purpose.[9] Section 311(a) states:

> no gain or loss shall be recognized to a corporation on the distribution, with respect to its stock, of its stock (or rights to acquire its stock), or property.

§ 311(a). Congress reinforced the strength of this rule by enacting § 162(*l*) (now § 162(k)) after the Fifth Circuit recognized a narrow exception in *Five Star Manufacturing Co. v. Commissioner*, 355 F.2d 724 (5th Cir. 1966) (deduction allowed when expenditures made to save the corporation from dire and threatening circumstances). Section 162(k)(1) unreservedly prohibits corporations from taking deductions for distributions made in the course of reacquiring its stock:

> Except as provided in paragraph 2, no deduction otherwise allowable shall be allowed under this chap-

---

[9] The Code treats the membership interests held by Union Mutual's policyholders as "stock". *See* § 7701(a)(7) ("the term 'stock' includes shares in an . . . insurance company"). The Code also treated Union Mutual's policyholders as stockholders in a corporation. *See* § 7701(a)(8) ("the term 'shareholder' includes a member in an . . . insurance company.").

> ter for any amount paid or incurred by a corporation in connection with the reacquisition of its stock. . . .[10]

§ 162(k)(1). The reference to "this chapter" is to Chapter One of the Code (I.R.C. §§ 1-1399), which includes both the general corporate tax provisions in Subchapter C and the insurance tax provisions on Subchapter L. While § 162(k)(2) does contain some exceptions to the general rule,[11] none of these apply to insurance companies. By its literal terms, therefore, § 162 forecloses any deduction for the cash distributed by UNUM.[12]

---

[10] *Cf.* I.R.C. § 317(b), providing that "[f]or purposes of this part, stock shall be treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, whether or not the stock so acquired is cancelled, retired, or held as treasury stock."

[11] Section 162(k)(2) provides that:

> (2) Exceptions.—Paragraph (1) shall not apply to—
>
> (A) Certain deductions.—Any—
>
> (i) deduction allowable under section 162 (relating to interest)
>
> (ii) deduction for amounts which are properly allocable to indebtedness and amortized over the term of such indebtedness, or
>
> (iii) deduction for dividends paid (within the meaning of section 561)
>
> (B) Stock of certain regulated investment companies—Any amount paid or incurred in connection with the redemption of any stock in a regulated investment company which issues only stock which is redeemable upon the demand of the shareholder.

The "dividends paid" deduction under § 561 does not include policyholder dividends, but only includes dividends as described in § 316 "relating to [the] definition of dividends for purposes of corporate distributions". § 562(a).

[12] The legislative history of § 162 supports the conclusion that § 162(k) forecloses a deduction for UNUM in this case. The Committee Report suggests that Congress intended § 162(*l*) (now § 162(k)) to be construed broadly to foreclose any deduction for

The Code is equally clear that UNUM may not deduct the value of the *stock* distributed in exchange for equity interests. Section 354(a) provides

> No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan or reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

§ 354(a). Section 354 thus bars any deduction for the exchange of UNUM stock for the membership interests of Union Mutual pursuant to the conversion plan. And § 1032(a) provides

> No gain or loss shall be recognized to a corporation on the receipt of money or property in exchange for stock (including treasury stock) of such corporation.

§ 1032(a). As is the case with § 162(k) and § 311, these Code sections do not contain provisions excluding insurance companies from their scope.

---

payments in connection with redemptions, except for those specifically enumerated in the statute.

> The conferees intend that the denial of deductibility will apply to amounts paid in connection with a purchase of stock in a corporation, whether paid by the corporation directly or indirectly, e.g., by a controlling shareholder, commonly controlled subsidiary or related party.
>
> The conferees wish to clarify that, while the phrase "in connection with [a] redemption" is intended to be construed broadly, the provision is not intended to deny a deduction for otherwise deductible amounts paid in a transaction that has no nexus with the redemption other than being proximate in time or arising out of the same general circumstances.

H.R. Conf. Rep. No. 99-841, 99th Cong., 2d Sess at II-168, *reprinted in* 1986 U.S.C.C.A.N. 4075, 4256. In this case, there is a clearly established nexus in that the payment "does . . . represent consideration for the [membership interests] or expense related to [their] acquisition. . . ." *Id.* at 4257.

E. *Section 808*

We find nothing in § 808 that specifically overrides these general rules. Indeed, that § 808 does not even *mention* these rules suggests that it may have nothing to do with capital transactions altogether.

Congress has been explicit in those situations when it wished Subchapter L to modify Subchapter C. *See* § 805 (b) (modifying the interest deduction under § 163, the charitable contributions deduction under § 170, the rules for amortizable bond premium under § 171, the net operting loss deduction under § 172, and the dividends received deductions under §§ 243-245). Congress could have done the same with the Code sections that directly govern UNUM's demutualization. That Congress did not choose to do so strongly suggest that Congress wanted those sections to apply with full force.

Our view that Congress did not intend the demutualization process to be exempted from these general tax rules is strengthened when we examine § 808(a). UNUM essentially makes a two-step argument regarding § 808(a): (1) any distribution which fits the strict language of § 808(b) is a "policyholder dividend" for purposes of § 808, regardless of the language of § 808(a): and (2) because the transaction here is a "policyholder dividend" under § 808, UNUM is entitled to a deduction under § 805(a)(3). We reject the first prong, so the second collapses accordingly.

UNUM argues that the term "polyholder dividend" under § 808 is not bound by the constraints that usually characterize dividends, but includes any distribution that can fit within the language of § 808(b)(1): "any amount paid or credited . . . where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management." We reject this reading of § 808.

Basic canons of statutory construction require us to consider the language of § 808(a) in construing § 808(b).

See United States Nat'l Bank of Or. v. Indep. Ins. Agents of America, Inc., 508 U.S. 439, 455, 113 S.Ct. 2173, 124 L.Ed.2d 402 (1993) (Courts must "at a minimum . . . account for a statute's full text, language as well as punctuation, structure, and subject matter."). Section 808(a) states:

> For purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.

§ 808(a). This text may be divided into three components. The "[f]or the purposes of this part" language requires that the definition of "policyholder dividend" has no force beyond Part I of Subchapter L, which specifically involves the taxation of life insurance companies; thus § 808 cannot govern a transaction basically within the purview of Subchapter C. The "any dividend or similar distribution" language requires all "policyholder dividends" to possess the essential characteristics of a dividend. Finally, the "to policyholders in their capacity as such" requires that the dividend-like distributions be based on the contractual relationship between the policyholder and insurer. We interpret the language of § 808(a) to mean exactly what it says. Any distribution by an insurer to its policyholders must accordingly bear the essential characteristics of a dividend and be based on the contractual relationship between the policyholder and insurer in order to qualify as a "policyholder dividend". And if § 808(a) is not satisfied, then § 808(b) cannot be satisfied either.

UNUM attempts to circumvent the plain meaning of § 808(a) by arguing that the language of § 316 specifically exempts "policyholder dividends" from the constraints that bind typical corporate dividends. Section 316(a) defines the term "dividend" as follows.

> For the purposes of this subtitle, the term "dividend" means any distribution of property made by a cor-

> poration to its shareholders . . . out of its earnings and profits of the taxable year. . . .

§ 316(a). By its terms, this definition of dividends applies to Subtitle A, 26 U.S.C. §§ 1-1563, which includes the portion of the Code governing income taxation. Section 316(b) limits the extent of the application of this definition:

> The definition in subsection (a) shall not apply to the term 'dividend' as used in Subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such.

§ 316(b). UNUM argues that the language of § 316(b) demonstrates that "policyholder dividends" have broader scope than "dividends" as defined in § 316(a), so it would be erroneous to conclude that policyholder dividends should be deemed a type of dividend as that term is so defined. It is true that § 316(b) means that a policyholder dividend under § 808 is not limited to distributions out of the insurer's earnings and profits and may include additional amounts from other sources. But, UNUM's assertion notwithstanding, it does not follow that because "policyholder dividends" may include more than classic corporate dividends then "policyholders dividends" may therefore encompass any distribution to policyholders regardless of its context or purpose.[13] As Judge Carter appropriately noted,

---

[13] UNUM cites dicta in *Republic Nat'l Life Ins. Co. v. United States*, 594 F.2d 530, 532 (5th Cir.1979), describing the "policyholder dividend" as "expansive." Because policyholder dividends are "expansive," UNUM argues, policyholder dividends can encompass even value-for-value exchanges that occur during a corporate recapitalization. This argument misapprehends the meaning of *Republic Nat'l Life*. In that case, the court was referring to the fact that the definition of "policyholder dividend" is expansive relative to the "classic dividend" definition, adding that "Congress intended to include more than just classic dividends" within policyholder dividends. *Id.*

> The fact that "policyholder dividend" is, in certain respects, broader in scope than "classic dividend" neither implies, nor even suggests, that Congress intended "policyholder dividends" to be construed broadly.

UNUM Corp. v. United States, 929 F.Supp. 15, 20 n. 6 (D. Maine 1996). Indeed, the term "policyholder dividend" is still a defined category. That it possesses a broader scope than the term "dividend" as defined in § 316(a) suggests only that policyholder dividends are different from ordinary corporate dividends, not that they are fundamentally unlike them.

F. *The distributions are not dividends*

This analysis suggests that the lengthy debate as to whether and how policyholder dividends are like or unlike corporate dividends is largely beside the point. All dividends, whether policyholder dividends or corporate dividends, share certain essential characteristics. The focus should be on whether the stock and cash distributions bear the essential characteristics which qualify them as a dividend of any stripe. We find that the cash and stock distributions at issue in this case simply are not "policyholder dividends" as that term is defined, because they are fundamentally not dividends or distributions similar to dividends as § 808(a) requires. Because they do not meet the definition of § 808(a), § 808(b) is superfluous. Moreover, because the distributions do not meet the definition of § 808(a), they are still subject to the general corporate tax rules of Subchapter C, under which they may not be deducted.[14]

---

[14] While the holding in this case would be the same whether or not there was a PFA, the existence of the PFA is added evidence that the economic reality of this transaction is that the conversion of mutual membership interests to stock is not a policyholder dividend. The PFA, a crucial element in the decision of the Maine Insurance Commissioner to approve this transaction, is an accounting

The economics of the demutualization compel this conclusion. A dividend, even a policyholder dividend, is a unilateral distribution by a company to its owners (who, in the case of mutual life insurance companies, also happen to be customers). No matter how large, a dividend still leaves intact the owner's equity interest in the company. But the cash and stock distributions for which UNUM seeks a deduction were not unilateral distributions by a company to its owners. Both were made in exchange for policyholders' membership interests in the former mutual company. Those who received cash had their equity interests extinguished, transactions amounting to classic redemptions. Those who received stock had their equity converted from one form to another, transactions which were classic non-recognition exchanges. No authority exists supporting the proposition that the term "dividend" encompasses such transactions.

UNUM nevertheless argues that the distributions should still be characterized as "policyholder dividends" because, removed from context, they can plausibly be shoe-horned into the text of § 808(b)(1). Judge Carter deftly explained the fallacy of UNUM's argument as follows:

> The fact that Congress intended life insurers to be able to deduct any dividend-like distribution to policyholders to the extent of its capital-like component neither implies, nor even gives rise to the inference, that Congress also intended life insurers to be able to deduct any distribution at all to policyholder that contains a capital-like component to the extent of that component.

UNUM Corp. v. United States, 929 F.Supp. at 24 n. 15.

UNUM's argument clouds the reason why § 316 distinguishes policyholder from regular corporate dividends.

---

mechanism which recognizes (in the common sense of the word) that policyholder dividend expectations may be segregated from other ownership interests and the two are not equivalent.

Policyholder dividends typically include a capital component in addition to earnings and Congress wished to provide a deduction for that component. *See* § 805(a)(3); § 809 (limiting the extent of the deduction). But the fact that "policyholder dividends" may include additional components does not change the fact that they must still essentially constitute dividends as § 808(a) expressly requires. The acknowledgement reflected in § 316(b) that policyholder dividends are more expansive than classic dividends does not alter this conclusion.

As the district court observed, UNUM's bootstrapping argument ignores other sources of authority on what constitutes a "dividend." In *Hellmich v. Hellman*, 276 U.S. 233, 48 S.Ct. 244, 72 L.Ed. 544 (1928), the Supreme Court described a dividend as

> the recurrent return upon stock paid to stock holders by a going corporation in the ordinary course of business, which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock.

Id. at 237, 48 S.Ct. at 245. Similarly, the Supreme Court in *United States v. Davis*, 397 U.S. 301, 90 S.Ct. 1041, 25 L.Ed.2d 323 (1970), described a "dividend" as a distribution whose

> effect is to transfer the property from the company to its shareholders without a change in the relative interest or rights of the stockholders.

Id. at 313, 90 S.Ct. at 1048 (emphasis added). A distribution is "not essentially equivalent to a dividend" if it "result[s] in a meaningful reduction of the shareholder's proportional interest in the corporation." *Id.* In light of this authority, we do not view distributions of stock or cash by a mutual insurer in consideration for the same value of ownership interest in a mutual company to be a dividend under any definition of the term, including a "policyholder dividend" under § 808.

The cash distribution is not a dividend or similar to a dividend precisely because it did reduce (to zero) the ownership interest of those policyholders who received cash and left them in no position to enjoy future returns, except as policyholders. *Cf. Hellmich*, 276 U.S. at 237, 48 S.Ct. at 245-46. It was thus akin to a nondeductible distribution in redemption. In contrast, the stock distribution was not a dividend or similar to a dividend because it was not in the nature of a "recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business." *Id.* Rather, it effected a conversion of one form of equity to another through a classic non-recognition exchange.

G. *Other reasons*

The fact that UNUM's demutualization occurred through a holding company suggests additional reasons why UNUM is also not, for other reasons, entitled to a "policyholder dividend" deduction. First, UNUM, which distributed its stock to policyholders in exchange for their membership interests in Union Mutual, is not a "life insurance company" as defined in § 816(a); the tax consequences of the stock distributions are accordingly subject to general corporation tax provisions in Subchapter C, which disallow the deduction. *See* § 354(a); § 1032(a). Second, the term "amount paid" in § 808(b)(1) requires distributions out of the company's surplus, whereas the stock distribution came from the holding company. Union Mutual did not actually "pay" anything in making that exchange. It is true that UNUM is the sole owner of a life insurance company, but having structured the demutualization as it did, UNUM must "accept the tax consequences of [its] choice." *See Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149, 94 S.Ct. 2129, 2137, 40 L.Ed.2d 717 (1974).[15]

[15] The one aspect of the demutualization involving the stock of a life insurance company was the transaction between the new

Even so, our decision does not rely on the fact that UNUM structured its demutualization through a holding company. Sections 354(a) and 1032(a) would apply to the demutualization regardless of its form, even if Union Mutual distributed stock in the new stock company in direct exchange for the membership interests of its policyholders.

UNUM's best argument may be the analogy it draws between a mutual insurance company liquidation and demutualization. When a mutual insurance company is liquidated, its assets are distributed to the policyholders and those distributions may be called dividends. This reorganization, the company says, is functionally equivalent to such a liquidation because Union Mutual no longer exists on completion of the demutualization. There are two responses. The first is that the analogy does not work. The very nature of a demutualization fundamentally distinguishes it from a liquidation in that the insurer is still in business after the conversion is complete. In the present case, the policyholders continue to be provided insurance, albeit through a different form of company and under a different name. Indeed, ensuring that Union Mutual would continue to meet its policyholders' reasonable expectations on the investment value of their policies was the very purpose of the PFA, which calculated the amount of assets necessary to pay policy claims, provide policyholder dividends, and satisfy whatever other benefits accrued to policyholders under their insurance contracts. Notably, the Maine Insurance Commissioner gave his blessing to the transaction only on being assured there

---

stock life insurer, UNUM Life, and the holding company, UNUM, in which the stock company exchanged 100% of its shares for 100% of the membership interest in Union Mutual. A transaction between two corporations can not come within the rubric of § 808, which involves distributions to "policyholders in their capacity as such." Instead, it constitutes a recapitalization under § 368(a)(1)(E), as the IRS confirmed, in response to UNUM's request, in Priv. Ltr. Rul. 87-11-121.

was sufficient capital preserved, together with premiums, to cover the insured risks in the future. This does not happen in the usual liquidation and, indeed, demonstrates that UNUM's demutualization cannot properly be so characterized.

Secondly, even if the analogy were apt in general, we have little reason to think Congress intended that final distributions of all assets to be within the definition of "policyholder dividends" under § 808(a). Congress could easily have provided for this deduction by enacting specific language to that effect. Had Congress wanted to provide insurance companies with a "policyholder dividend" deduction for any distribution to policyholders not fixed in the contract, it could simply have defined "policyholder dividend" as referring to "any distribution." It would not have limited the definition to "dividends or similar distributions" and then left it to the insurance industry to discover massive deductions in the shadows of the statute.

Although we think the plain meaning of § 808 works against, and not for, UNUM, and mindful of the usual rule that resort to legislative history is inappropriate in such circumstances, we do briefly explain UNUM's policy and legislative history argument. Our primary purpose in so doing is to determine whether there is a clearly expressed legislative intention which would cause us to question application of the usual rule. *INS v. Cardoza-Fonseca,* 480 U.S. 421, 432 n. 12, 107 S.Ct. 1207, 1214, n.12, 94 L.Ed.2d 434 (1987). A secondary reason is to note that UNUM's policy arguments are not implausible; they simply do not carry UNUM's burden of showing clearly that Congress intended such a deduction.

In support of its statutory argument, UNUM offers an extended account of the legislative history and public policy behind the Code's scheme of life insurance company taxation. UNUM argues that Congress specifically created the "policyholder dividend" deduction to equalize

the tax treatment of mutual insurers relative to stock insurers. Under general tax rules, stock companies are not taxed on capital raised by selling stock, but may not deduct amounts paid to redeem that stock. (No tax, no deduction) At the same time, mutual insurers must pay income tax on capital raised by charging redundant premiums; but absent the policyholder dividend deduction, they may not deduct amounts paid to return capital to policyholders, which typically occur through policyholder dividends. (Tax, but no corresponding deduction) By creating the policyholder dividend deduction in § 805 (a)(3), UNUM explains, Congress intended to create symmetry in the taxation of mutual insurers and thus provide equal tax treatment for both mutual and stock insurers.

UNUM emphasizes the expansiveness of "policyholder dividends" by contrasting them with a "return premium". Return premiums are refunds that occur when a policy is cancelled, where the amount of the refund generally represents that portion of paid premiums not applied to the purchase of coverage up to the time of cancellation. Robert A. Keeton & Alan I. Widiss, *Insurance Law: A Guide to Fundamental Principles, Legal Doctrines, & Commercial Practices* § 5.11(d)(2) (1988). UNUM explains that these amounts are "fixed in the contract" in that they are based on the terms of the contract. "Policyholder dividends" are, in contrast, any amounts not fixed in the contract, i.e., any distributions from surplus (that depend on the experience of the company or the discretion of management) that are not return premiums.

Under Subchapter L, UNUM explains, Congress divided amounts returned to policyholders into the categories of "return premiums" and "policyholder dividend". Return premiums are deductible, because they contain a return of premiums. Policyholder dividends are also deductible, because, like return premiums, they are in part returns of capital. Policyholder dividends are only de-

ductible in part, however, because they can also contain earnings from the investment of the premiums which are nondeductible under general tax law.

To account for this, UNUM argues, Congress created an expansive definition of "policyholder dividend" in § 808 and enacted § 809 to control the extent of the deduction, since the expansive language does not admit limitation. UNUM claims that § 809 is the sole mechanism by which policyholder dividends should be limited, not through judicial construction of the scope of the definition of "policyholder dividend" under § 808. Policyholder dividends should be, in effect, any distribution that a mutual insurer makes to policyholders out of surplus for any reason, and only the terms of § 809 limit the reach of the deduction.

UNUM argues that the facts that Congress created the policyholder dividend deduction to achieve a tax symmetry and that Congress accordingly defined "policyholder dividend" to possess broad scope necessarily compels the conclusion that "policyholder dividends" must even include distributions to policyholders that are fundamentally not dividends. We believe this conclusion is unsupported by the text or policies underlying the statute. UNUM's analysis of the legislative history and public policy underlying the insurance tax provisions of the Code suffers from the same flaw that undermines its statutory argument. Nothing UNUM cites supports the proposition that Congress intended the term "policyholder dividends" to encompass value-for-value exchanges occurring during a corporate reorganization. UNUM's argument fails not because it relies on erroneous facts, but rather because those facts simply do not support the conclusions UNUM wishes to draw.

In the end, the mere fact that "policyholder dividends" are not "fixed" by the terms of an insurance contract does not mean that they include any distribution that a mutual

insurer makes to its policyholders in any capacity. Under § 808(a), in order for a distribution to qualify as a "policyholder dividend", the distribution must occur to policyholders "in their capacity as such"—i.e., in their capacity as policyholders, not owners. The distribution must also fundamentally be a "dividend or similar distribution." For the reasons explained in the balance of the opinion we believe that the cash and stock distributions made by UNUM were not dividends. Rather, the cash distribution constituted a nondeductible distribution in redemption, while the stock distribution was part of a nonrecognition exchange.

III

In *Colonial American*, the Supreme Court faced a case similar to this one. As here, the taxpayer made a colorable argument that Subsection L provided for tax treatment that general tax law otherwise prohibited. Similarly, the IRS responded that the basic policies and structure of the Code defeated the taxpayer's argument. The Supreme Court, explaining its decision in favor of the IRS, stated:

> It cannot be denied that the language on which petitioner relies, taken in isolation, could be read to authorize the tax treatment it seeks. . . . But when the statutory and regulatory language is parsed more carefully, petitioner's position becomes dubious, and when the language is read against the background of the statutory structure, it becomes untenable.

Colonial American, 491 U.S. at 257, 109 S.Ct. at 2417. We believe the same to be true in this case. To accept UNUM's arguments "we would have to conclude that Congress subsumed a major deduction within the fine details of its definition" of the policyholder dividend. *Id.* at 260, 109 S.Ct. at 2418. We do not believe that Congress intended to conceal in § 808 a deduction of this magnitude.

INDOPCO requires a taxpayer to carry the burden of proof that it is entitled to a claimed deduction. Despite UNUM's arguments, we do not believe that § 808 and § 805 apply to value-for-value exchanges as occurred in this insurance company demutualization.

We affirm the judgment of the district court. Costs to appellees.

APPENDIX B

UNITED STATES DISTRICT COURT
D. MAINE

Civil No. 93-369-P-C

UNUM CORPORATION and UNUM LIFE INSURANCE COMPANY OF AMERICA,
Plaintiffs,

v.

UNITED STATES OF AMERICA,
Defendant.

May 23, 1996

MEMORANDUM OF DECISION AND ORDER

GENE CARTER, Chief Judge.

Plaintiffs UNUM Corporation ("UNUM Corp.") and UNUM Life Insurance Company of America ("UNUM America") sue Defendant United States of America ("the Government" or "the IRS") seeking a tax deduction valued at approximately eighty million dollars. Plaintiffs claim that the cash and stock distributed to their policyholders pursuant to Plaintiffs' Plan of Recapitalization and Conversion, Stipulated Record (Docket No. 42) Ex. 16 ("the Plan"), constitute "policyholder dividends" as defined in § 808 of the Internal Revenue Code, 26 U.S.C.

§ 1 *et seq.* ("the Code" or "I.R.C."), and so are deductible from income pursuant to § 805(a)(3) of the Code. Having denied Defendant's Motion for Summary Judgment, Memorandum and Order Denying Defendant's Motion for Summary Judgment (Docket No. 40), the Court now considers this case for final decision on a stipulated record. *See* Stipulated Record (Docket No. 42) ("Record"). For the reasons discussed below, the Court will find that neither the cash distribution nor the stock distribution constitutes a "policyholder dividend" and, therefore, that neither distribution is deductible from Plaintiffs' income.

I. FACTS

Union Mutual Life Insurance Company ("Union Mutual") was organized as a mutual insurance company in Maine in 1848. Record Ex. 31. At all times relevant to this action, Union Mutual was engaged in the business of writing various forms of life insurance, health and accident insurance, and annuity products. *Id.* ¶ 1. As with mutual companies generally, Union Mutual had no outstanding capital stock and so was not owned by stockholders. *Id.* ¶ 4. As with mutual insurance companies generally, Union Mutual was owned, instead, by its participating policyholders. *Id.* Ex. 8 at 6, Ex. 12 at 15.

Union Mutual's participating policyholders owned the company by virtue of having contributed to Union Mutual's surplus by paying premiums that exceeded the actuarial cost of their policy coverage. Plaintiffs' Trial Brief (Docket No. 44) at 4-5, 18-19 ("Plaintiffs' Brief"); United States' Trial Brief (Docket No. 43) at 3-4 ("Government's Brief"); Record Ex. 8 at 6, Ex. 12 at 15. These excess amounts functioned in a way analogous to the capital raised when a stock insurer makes an offering of its stock. Plaintiffs' Brief at 12-13; Plaintiffs' Reply Brief (Docket No. 45) at 5; Government's Brief at 3-4. Accordingly, in proportion to that contribution to surplus,

each Union Mutual policyholder had certain rights analogous to those of a stockholder, such as voting rights and preemptive rights upon conversion. Plaintiffs' Brief at 18-19; Government's Brief at 3-4; Record Ex. 4 at 5; Plan at A-2.

Taken as a whole, the surplus to which Union Mutual policyholders contributed represented the sum of all revenues in excess of the amount paid or accrued for benefits, reserves, dividends, taxes, and other expenses. Record ¶ 7. As such, Union Mutual's surplus also provided the source from which policyholder dividends were drawn in an amount determined by Union Mutual management on an annual basis. *Id.* Ex. 8 at 6.

As of December 31, 1985, Union Mutual had accumulated surplus, determined on the basis of generally accepted accounting principles ("GAAP"), in the amount of $652,050,097 ("GAAP Surplus"). *Id.* ¶ 9.

A. Formulation of the Recapitalization and Conversion

In December 1984, Union Mutual submitted its initial Plan of Recapitalization and Conversion, Record Ex. 9 ("Initial Plan"), to the Maine Superintendent of Insurance for approval. Record ¶ 15, 16. The Initial Plan detailed a transaction whereby Union Mutual would convert from a mutual insurer to a stock insurer that would be wholly-owned by a new holding company. *See* Initial Plan. The approval process was directed at ensuring that the Initial Plan complied with Maine law governing such a conversion. *See* 24-A M.R.S.A. § 3477. To that end, between June 1985 and July 1986, the Superintendent issued two legal rulings regarding the Initial Plan, and the Union Mutual Board of Directors amended the Initial Plan four times. Record ¶¶ 17-22, Exs. 10-15. Finally, on August 8, 1986, the Superintendent issued a Final Decision and Order approving the final version of the Plan. *Id.* ¶ 24, Ex. 17.

Among other things, the final Plan provides that "[i]n exchange for their Membership Interests, Eligible Policyholders will receive Conversion Stock or cash, all as described in Part VII of this Plan." Plan at A-4. Part VII, entitled "Subscription Offering," begins as follows:

> A. *Eligible Policyholders.*
>
> 1. *Equity Share.* In order to determine the consideration to be provided to Eligible Policyholders in exchange for their Membership Interests, an amount equal to the Adjusted Surplus of Union Mutual shall be allocated among such Eligible Policyholders in accordance with the formulas [provided elsewhere in the Plan for calculating each Eligible Policyholder's Equity Share]. Each Eligible Policyholder's allocation as so determined shall be that Eligible Policyholder's Equity Share.

Plan at A-4. Eligible Policyholders would receive their Equity Share in the form of Conversion Stock unless they qualified as "Cash Option Eligible Policyholders," in which case, they could choose to receive the same Equity Share in the form of cash. Plan at A-1, A-5. Moreover, once Eligible Policyholders thus exchange their Membership Interests for their Equity Shares (whether in stock or cash) of the Adjusted Surplus, "present and past policy and contract holders will have no Membership Interests in Union Mutual." Plan at A-4.

The Plan also provides three particularly important definitions, which this Court hereby adopts, for terms used above to describe the transaction. First, "Membership Interest" is defined as:

> all rights and interests of each policy and contract holder of Union Mutual including, but not limited to, any right to vote, any rights which may exist with regard to the surplus of Union Mutual not apportioned

> by the Board for policyholder dividends, and any rights in liquidation or reorganization of Union Mutual, but shall not include any other right expressly conferred by a policyholder's insurance policy or contract.

Plan at A-3. Second, "Equity Share" is defined as "the dollar amount of that part of Union Mutual's Adjusted Surplus attributable to that Eligible Policyholder on the basis of the formulas [provided elsewhere in the Plan for calculating Equity Share.]" Plan A-1. Third, "Adjusted Surplus" is defined as "the amount of surplus as of December 31, 1985 . . . [as determined] in accordance with generally accepted accounting principles. . . ." Plan at A-1.

Maine law requires such a conversion plan to be approved by at least two-thirds of those policyholders who vote on it. *See* 24-A M.R.S.A. § 3477(2)(B). The Plan was approved by ninety-eight percent of those Eligible Policyholders who voted on it. Record ¶ 29.

B. Execution of the Recapitalization and Conversion

The following series of transactions (collectively "Recapitalization and Conversion") occurred on or about November 14, 1986, the effective date of the Plan. Record ¶ 32. Union Mutual disbursed $129,129,082 in cash by check to the 105,098 Cash Option Eligible Policyholders who chose to exercise that option. *See id.* Ex. 24, ¶ 33. Union Mutual charged this entire amount against its statutory and GAAP surplus. *Id.* ¶ 34.

Union Mutual amended its charter both to convert the company from a mutual insurer to a stock insurer and to change the company name to UNUM Life Insurance Company ("UNUM Life"). *Id.* ¶¶ 5, 31, 32.

UNUM Life delivered all 6,000,000 of its newly-minted shares of stock to the new holding company, UNUM Corp.

Id. ¶¶ 35, 36, Ex. 22. "[I]n consideration for" those 6,000,000 shares of UNUM Life stock, UNUM Corp. issued 20,489,072[1] shares of UNUM Corp. stock to the remaining 58,561 Eligible Policyholders. *Id.* ¶ 37, Ex. 22, 24. At a fair market value of $25.50 per share on the effective date, the total value of the UNUM Corp. Conversion Stock distribution to those Eligible Policyholders was $522,471,336. *Id.* ¶ 38, Ex. 24.

In addition, to the extent that the value of the Equity Share of those 58,561 Eligible Policyholders exceeded the value of a whole number of UNUM Corp. shares by the value of some fractional share, Union Mutual distributed to those Eligible Policyholders an additional $609,396 in cash to represent the value of those fractional shares. *See Id.* Ex. 24, ¶ 33.[2]

By the conclusion of the Recapitalization and Conversion, 163,659 Eligible Policyholders had received distributions of cash and stock in the amount of $652,209,814.[3] *Id.* Ex. 24, ¶ 45.

C. Taxation of the Recapitalization and Conversion

The process of determining the federal tax consequences of the Recapitalization and Conversion began on October

---

[1] This finding of fact is based upon the parties' stipulation that UNUM Corp. distributed 20,489,072 shares of its own stock to Eligible Policyholders as part of the Recapitalization and Conversion. Record Ex. 24. This Court disregards other indications in the record that 20,508,915 shares were issued. *See id.* Ex. 22.

[2] In addition to the above distributions to Eligible Policyholders, the Recapitalization and Conversion involved other transactions, including the sale of UNUM Corp. stock at $25.50 per share to employees and to the general public, as well as the investment of capital by UNUM Corp. in subsidiaries of the former Union Mutual. Record ¶¶ 34, 41.

[3] This total exceeds GAAP Surplus by less than one-twentieth of one percent because of distributions made after November 14, 1986, but before December 31, 1986, to a small number of belatedly identified Eligible Policyholders. *See* Record Ex. 24.

12, 1984, over two years before the effective date of the Plan, when Union Mutual's tax counsel submitted a request for a letter ruling to the IRS. Record ¶ 11, Ex. 4. In that request, Union Mutual sought to convince the IRS that the distribution of UNUM Corp. stock in exchange for Membership Interests in Union Mutual constituted a tax-free exchange under I.R.C. § 351, and that the conversion of those Membership Interests into UNUM Life stock constituted a tax-free recapitalization under I.R.C. § 368(a)(1)(E). *Id.* Ex. 4 at 22, 24.

During the years 1984 through 1986, Union Mutual's tax counsel made numerous additional submissions to the IRS pertaining to the initial request. *Id.* ¶ 11, Ex. 5. One such submission, dated November 8, 1985, discussed the issue of whether the distribution of cash in exchange for Membership Interests should be treated as a "redemption" in exchange for Membership Interests under I.R.C. § 302 or as a "policyholder dividend" under I.R.C. § 808 but did not request a letter ruling on that issue. *Id.* Ex. 5.

On December 16, 1986, the IRS issued its letter ruling to Union Mutual regarding the Recapitalization and Conversion. Record ¶ 12, Ex. 6 ("Letter Ruling"). The Letter Ruling agreed with Union Mutual's characterization of the stock distribution as a tax-free exchange under § 351 and of the conversion as a tax-free recapitalization under § 368(a)(1)(E). Letter Ruling at 9, 11. The Letter Ruling added that the cash distribution should be treated as a "redemption" under § 302 rather than a "policyholder dividend" under § 808. Letter Ruling at 12.

Beginning with the taxable year ending December 31, 1986, UNUM Life joined in the filing of a life-nonlife consolidated tax return with its parent, UNUM Corp., and with its other affiliates. Record ¶ 48. The original federal income tax return filed for that year did not seek a deduction for any part of the cash or stock distributed pursuant to the Plan. *Id.* ¶ 49, Ex. 25. Since then, UNUM Life has merged with and into UNUM Life In-

surance Company of America ("UNUM America"), which remains Union Mutual's surviving corporate successor and a wholly-owned subsidiary of UNUM Corp. *Id.* ¶¶ 53, 54, 56.

On May 15, 1992, current Plaintiffs, UNUM Corp. and UNUM America, timely filed refund forms claiming that the cash ($12,738,478) distributed to Eligible Policyholders pursuant to the Plan on its effective date was deductible as a "policyholder dividend" under I.R.C. §§ 805(a)(3) and 808. *Id.* ¶ 50, Ex. 26. On September 25, 1992, Plaintiffs timely filed refund forms claiming that the fair market value of the UNUM Corp. stock ($552,471,336) distributed to Eligible Policyholders pursuant to the Plan on its effective date was deductible as a "policy-holder dividend" under I.R.C. §§ 805(a)(3) and 808. *Id.* ¶ 51, Ex. 27.

On March 12, 1993, the IRS sent a letter to Plaintiffs proposing to disallow the refund claims. *Id.* ¶ 52. On December 29, 1993, after protesting this proposed disallowance administratively through the IRS Appeals Office, Plaintiffs filed this suit to obtain the refunds. *Id.* ¶ 52; *see* Complaint (Docket No. 1).

II. DISCUSSION

The dispositive issue in this case[4] is whether the Recapitalization and Conversion distributions of cash and UNUM Corp. stock to former Union Mutual policyholders fall within the definition of "policyholder dividend"

---

[4] In the course of opposing Plaintiffs' contentions, the Government claims that the cash distributions constitute redemptions under I.R.C. § 302 and that the stock distributions constitute exchanges under I.R.C. § 351. *See* Government's Brief at 19-23. It is not necessary to reach the Government's claims regarding §§ 302 and 351 in order to address the dispositive issue, *i.e.*, whether the cash and stock distributions constitute "policyholder dividends" under I.R.C. § 808. Therefore, the Court wil not reach the Government's claims regarding §§ 302 and 351.

contained in I.R.C. § 808 and are, therefore, deductible under I.R.C. § 805(a)(3).[5] The Court finds that neither the cash nor the stock distribution constitutes a "policyholder dividend" for two reasons: (1) neither distribution is a "dividend or similar distribution" as required by § 808(a); and (2) the amount of neither distribution "depends on the experience of the company or the discretion of the management" as required by § 808(b)(1).

A. Structural Overview

The analysis must begin by identifying the applicable provisions of the Internal Revenue Code and describing the relationship among those provisions.

Subchapter C of the Code applies to all corporations, which include insurance companies. *See* I.R.C. §§ 301, 7701(a)(3). Among those insurance companies to which subchapter C applies are life insurance companies, both stock and mutual. *See Duffy v. Mutual Benefits Life Ins. Co.*, 272 U.S. 613, 616, 47 S.Ct. 205, 205, 71 L.Ed. 439 (1926). Subchapter L also applies to insurance companies. *See* I.R.C. § 801. Among those insurance companies to which subchapter L applies are life insurance companies, both stock and mutual. *See* I.R.C. §§ 801-818.

Subchapter C, then, governs the taxation of life insurance companies, both stock and mutual, "[e]xcept to the extent that [subchapter L makes] specific provision." H.R.Rep. No. 34, 86th Cong., 1st Sess. (1959), *reprinted in* 1959-2 C.B. 736, 750; S.Rep. No. 291, 86th Cong., 1st Sess. (1959), *reprinted in* 1959-2 C.B. 770, 798. Such specific provisions of subchapter L are construed

---

[5] Section 805(a)(3) of the Code provides:

§ 805. General Deductions

(a) General rule.—For purposes of this part, there shall be allowed the following deductions:

(3) Policyholder dividends.—The deduction for policyholder dividends (determined under section 808(c)).

narrowly because they bestow tax benefits on insurers not generally available to other taxpayers. *Nat'l Life and Accident Ins. Co. v. United States*, 385 F.2d 832, 833 (6th Cir.1967). Moreover, provisions defining the scope of a deduction, regardless of their location in the Code, are construed strictly. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84, 112 S.Ct. 1039, 1042-43, 117 L.Ed.2d 226 (1992). Finally, "the burden of clearly showing the right to the claimed deduction is on the taxpayer," for "an income tax deduction is a matter of legislative grace." *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593, 63 S.Ct. 1279, 1281, 87 L.Ed. 1607 (1943).

The specific provision here at issue, the § 808 definition of a deductible "policyholder dividend," appears in subchapter L and defines the scope of a deduction. This Court, therefore, will construe the definition of "policyholder dividend" strictly.[6] Such a strict construction of

---

[6] Plaintiffs labor mightily to characterize the "policyholder dividend" deduction as so clearly intended by Congress to be construed broadly as to exempt it from the application of the ordinary canons of statutory construction discussed above. First, Plaintiffs cite dicta describing an earlier definition of "policyholder dividend" as "expansive." *Republic Nat'l Life Ins. Co. v. United States*, 594 F.2d 530, 532 (5th Cir.1979). There, the court was referring to the fact that the "policyholder dividend" definition was "expansive" in relation to the "classic dividend" definition, adding that "Congress intended to include more than just classic dividends" within policyholder dividends. *Id.* The fact that "policyholder dividend" is, in certain respects, broader in scope than "classic dividend" neither implies, nor even suggests, that Congress intended "policyholder dividend" to be construed broadly. Second, Plaintiffs point to the "any amount" language of § 808(b)(1) as an indication of the atypical breadth of this deduction. The "any amount" language, however, indicates only that any dollar value may be deducted: it does *not* indicate that any type of distribution may be deducted. In fact, § 808(b)(1) only describes one particular subtype of "policyholder dividend," and so should be read as subject to the general definition of "policyholder dividend" in § 808(a) that requires all "policyholder dividends" to be dividend-like. *See infra* Section II.B. Therefore, there is no warrant for excepting the

this specific provision of subchapter L will correspondingly displace the operation of subchapter C only very little. Finally, Plaintiffs may not prevail unless they meet their burden of proving clearly that the distributions fall within that narrow deduction.

It is within this broader framework that the Court now examines the precise language of § 808.

B. Is Either Distribution a "Dividend or Similar Distribution" Under § 808(a)?

Section 808(a) defines a "policyholder dividend" as "any dividend or similar distribution to policyholders in their capacity as such." I.R.C. § 808(a).[7] The parties to this action differ primarily over the meaning of "any dividend or similar distribution." Plaintiffs largely avoid addressing the meaning of this statutory language and thereby implicitly treat it as if it has no limiting effect on the scope of the term "policyholder dividend." *See* Plaintiffs' Brief at 19-20. The Government, by contrast, dedicates most of its trial brief to the claim that it is precisely this language that operates to exclude the present distributions from the "policyholder dividend" deduction. *See* Government's Brief at 10-26.

1. Is Either Distribution a "Dividend"?

"Dividend" is the first salient disputed term in the § 808(a) definition. Subchapter L itself provides no defi-

---

"policyholder dividend" deduction from ordinary canons of statutory construction that indicate the propriety of reading deductions narrowly.

[7] Section 808(a) of the Code provides:

> § 808. Policyholder dividends deduction
>
> (a) Policyholder dividend defined.—For purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.

nition of the term "dividend" specific to that subchapter. Subchapter C, however, does provide a definition for all of subtitle A, which includes subchapter L. I.R.C. § 316(a).[8] Section 316(a) defines "dividend," in relevant part, as "any distribution of property made by a corporation to its shareholders . . . out of its earnings and profits of the taxable year." *Id.*

Section 316(b)(1), however, expressly prohibits the application of the language of § 316(a) to subchapter L and, therefore, to § 808(a). I.R.C. § 316(b)(1).[9] Still, the language of § 316(a) does not exhaustively describe all limits on the meaning of "dividend"; other sources of

---

[8] Section 316(a) of the Code provides:

§ 316. Dividend defined

(a) General rule.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distribution made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

[9] Section 316(b)(1) of the Code provides:

§ 316. Dividend defined

(b) Special rules.—

(1) Certain insurance company dividends.—The definition in subsection (a) shall not apply to the term "dividend" as used in subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such.

law also help define the scope of the term. *See, e.g., Hellmich v. Hellman*, 276 U.S. 233, 236-37, 48 S.Ct. 244, 245-46, 72 L.Ed. 544 (1928). Section 316(b)(1), then, prohibits *only* the application of the language of § 316(a) to limit the meaning of "dividend"; § 316(b)(1) does not prohibit the application of those other sources of law that also help define the scope of the term.[10] Therefore, in light of § 316(b)(1), all sources of law, except for the language of § 316(a), that help define the scope of the term "dividend" as it is used outside subchapter L also help define the scope of "dividend" as it is used within subchapter L, including § 808(a).[11]

What, then, are those residual constraints on the meaning of "dividend"? In *Hellmich v. Hellman*, 276 U.S. 233,

---

[10] Indeed § 316(b)(1) *cannot* prohibit the application of other sources of law that help define "dividend" without thereby reading the term (and, consequently, "or similar") entirely out of the § 808(a) definition of "policyholder dividend." To read "dividend" as limitless in scope in the phrase "any dividend or similar distribution" is to read the phrase instead as "any distribution." Although amending the statute in this way apparently is Plaintiffs' desire, it plainly is not Congress's intent. *See* Plaintiffs' Brief at 30-31; Plaintiffs' Reply Brief at 2.

[11] This reading of the relationship among § 316(a), § 316(b)(1), and § 808(a) comports well with Congress's understanding of the substantive economic content of "policyholder dividends." Congress expects "policyholder dividends" to include not only earnings and profits, but a component analogous to a return of capital. *American Mut. Life Ins. Co. v. United States*, 43 F.3d 1172, 1173 (8th Cir. 1994); *see Republic Nat'l Life Ins. Co. v. United States*, 594 F.2d 530, 536 n. 21 (5th Cir.1979) (quoting legislative history). Indeed, policyholder dividends are deductible precisely because they contain that capital-like component and precisely to the extent of that component. *See* I.R.C. §§ 808(c)(2), 809. If, however, § 316(a) restrictions remained applicable to the term "dividend" in § 808(a), "policyholder dividends" would include only earnings and profits, thus excluding the targeted deductible capital-like component. Therefore, § 316(b)(1) allows the § 808(a) definition of "policyholder dividend" to include that deductible capital-like component without relaxing any other restrictions on the term "dividend."

48 S.Ct. 244, 72 L.Ed. 544 (1928), the Supreme Court applied two sources of law other than the language of the predecessor of § 316(a) to define "dividend." The *Hellmich* court first invoked case law reflecting the common usage of "dividend," describing it as:

> the *recurrent* return upon stock paid to stock holders by a going corporation *in the ordinary course of business*, which *does not reduce their stock holdings* and *leaves them in a position to enjoy future returns upon the same stock*.

Id. at 237, 48 S.Ct. at 245 (emphasis added). The Court then read the statutory provision defining affirmatively what a liquidation distribution *is* as also defining negatively what a dividend distribution *is not*. *Id.* Specifically, dividends are distinguishable from liquidations in that only the latter involve "a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation." *Id.* at 235, 48 S.Ct. at 245.

Similarly, in *United States v. Davis*, 397 U.S. 301, 90 S.Ct. 1041, 25 L.Ed.2d 323 (1970), the Court discussed the meaning of "dividend" in the context of another Code provision, again without reference to § 316(a). There, the Court described a "dividend" as a distribution whose "effect is to transfer the property from the company to its shareholders without a change in the relative economic interests or rights of the stockholders." *Id.* at 313, 90 S.Ct. at 1048. The court concluded, in turn, that a distribution is "not essentially equivalent to a dividend" if it "result[s] in a meaningful reduction of the shareholder's proportionate interest in the corporation." *Id.; see Bradbury v. Commissioner*, 298 F.2d 111, 115 (1st Cir.1962) (affirming that dividends do not change shareholders' proportionate interests in the corporation).

In light of these authorities, it comes as no surprise that Plaintiffs have not produced any case, statute, regulation, or other legal authority defining the term "dividend" as a distribution to a shareholder made in exchange

for a substantial reduction, not to mention a complete surrender, of the shareholder's proportional interest in the company.[12] Nor have Plaintiffs produced any such authority defining the term "dividend" as a distribution to a shareholder made in exchange for *any* form of property of equivalent value, proportional shareholder interest or otherwise.[13]

The term "dividend" in the § 808(a) definition of "policyholder dividend," then, does not include either of

---

[12] The closest semblance of contrary legal authority Plaintiffs produce is disputed expert opinion that "termination dividends" are made to policyholders in exchange for the surrender of all their proportional interests in the insurance company. Plaintiffs' Brief at 31-32. For several reasons, this opinion does not constitute valid contrary legal authority. First, expert opinion on a matter of law bears little, if any, persuasive authority, particularly when binding authorities, such as those discussed above, militate strongly against the opinion. Second, at least one expert denies that "termination dividends" are made *in exchange for* surrendering all proportional interests in the company. Deposition of Ralph J. Sayre, January 26, 1995, at 191. Instead, he affirms only that most "termination dividends" are made *upon the occasion of* surrendering proportional interests in the company. *Id.* at 192-93. Moreover, he denies that "termination dividends" represent the economic value of those surrendered proportional interests, or that "termination dividends" are distributed to compensate for, or to induce, the surrender of those interests. *Id.* at 48, 191. Third, the term "termination dividend" is not the term "dividend," but a term of art that may or may not be defined as a species of "dividend." (In other words, it may be defined in part as "any distribution, regardless of similarity to a dividend," just as Plaintiffs would define "policyholder dividend.") Therefore, even if "termination dividends" were distributions made in exchange for the surrender of all proportional interests in the company, that fact has no demonstrated relevance to whether "dividends" may be distributions made in exchange for the surrender of all proportional interests in the company.

[13] In fact, in exchange transactions between a noncorporate shareholder and a corporation, property the shareholder receives from the corporation is not even taxed as a distribution except to the extent that its value exceeds the value of the property the shareholder gives to the corporation. *See* Treas.Reg. § 1.301-1(j).

the distributions here at issue. Both the cash and stock distributions were made to Eligible Policyholders in exchange for the complete surrender of all their proportional interests in the former Union Mutual. Both the cash and stock distributions were made to Eligible Policyholders in exchange for property of equivalent value, namely, their Membership Interests in the former Union Mutual. Therefore, neither type of distribution may be considered a "dividend" for purposes of § 808(a).

2. Is Either Distribution a "Similar Distribution"?

Having determined that the "any dividend" language of § 808(a) does not include the present distributions, the question remains whether the "or similar distribution" language does. This language appears to broaden the meaning of "policyholder dividend" beyond the already broadened meaning of "dividend" discussed above.[14] If the "or similar distribution" language broadens "policyholder dividend," at all, however, it does so only in small measure given how narrowly both deduction provisions and subchapter L provisions should be read. *See supra* Section II.A.

The remaining question under § 808(a), then, is whether the "or similar distribution" language broadens "policyholder dividend" enough to include the distributions at issue. More precisely, the remaining question is whether Plaintiffs have met their burden to show clearly that Congress intended that a distribution that is dissimilar to a "dividend," both because it is made in exchange for complete surrender of a shareholder's proportional interest in a company and because it is made in exchange for property of equivalent value, nevertheless remains sim-

[14] The "or similar distribution" language, however, may be read not to broaden the meaning of "dividend" at all. Instead, it may simply emphasize and reinforce the more precise broadening function of § 316(b)(1): to indicate that the term "dividend" in subchapter L is not limited to earnings and profits.

ilar enough to a "dividend" to warrant the special tax treatment of a deductible "policyholder dividend." That question must be answered in the negative.

Plaintiffs make no attempt to show that the distribution in this case are similar to a "dividend" in any way, least of all similar in such a way and to such an extent as to warrant their inclusion among those distributions Congress clearly intended for deductibility. Rather than acknowledge the limiting effects of the "any dividend or similar distribution" language of § 808(a), Plaintiffs dwell on the capital structure of mutual insurance companies, the value of symmetry in taxation, and the economic content of actual policyholder dividends.[15] *See Penn. Mut.*

---

[15] The error underlying Plaintiffs' lengthy argument, by which they ignore the letter of § 808(a) but appeal to what they consider its spirit, may be stated comparatively briefly. The fact that Congress intended life insurers to be able to deduct *any dividend-like distribution* to policyholders to the extent of its capital-like component neither implies, nor even gives rise to the inference, that Congress also intended life insurers to be able to deduct *any distribution at all* to policyholders that contains a capital-like component to the extent of that component. Contrary to Plaintiffs contention, this Court does not consider the intention to limit the deduction only to dividend-like distributions so irrationally asymmetric and unfair that it should not be imputed to Congress. *See* Plaintiffs' Brief at 33-34; Plaintiffs' Reply Brief at 14-15. It is far from unfair for Congress to tax as income to mutual companies their capital-like funds upon receipt and then to allow a corresponding deduction for those funds upon distribution only when they are measured out in a certain form. (To be sure, Congress is free to allow no deduction at all.) Instead, limiting the deduction only to dividend-like distributions may be said to perform any number of legitimate purposes. One such purpose may be what Plaintiffs accurately identify as the purpose of certain provisions of previous regimes governing the deductibility of "policyholder dividends"—simply to limit life insurers' ability to use the deduction. Plaintiffs' Brief at 6-7, 10. Another such purpose may be to ensure the application to insurance companies, stock and mutual alike, of those provisions of subchapter C applying to all other companies, stock and mutual alike, that govern the taxation of certain distributions that are not dividend-like, such as distributions constituting re-

Life Ins. Co. v. Lederer, 252 U.S. 523, 527, 40 S.Ct. 397, 398, 64 L.Ed. 698 (1920). Accordingly, Plaintiffs do not even begin to carry their burden of showing that these distributions fit within the limits of that statutory language and, therefore, within the limits of Congress's intent to allow the deduction. Neither the cash nor the stock distribution in this case, then, constitutes a deductible "policyholder dividend" because neither meets the "any dividend or similar distribution" requirement of § 808(a).

C. *Does the Amount of Either Distribution "Depend[] on the Experience of the Company or the Discretion of the Management" Under § 808(b)(1)?*

Not only are the distributions in this case not "dividends or similar distributions" under § 808(a), they do not fall within any of the four subcategories of distribution specifically enumerated in § 808(b) as included among "policyholder dividends." Plaintiffs argue only that the distributions fit within the first of these categories, described in § 808(b)(1), which includes "any amount . . . [that] is not fixed in the contract but depends on the experience of the company or the discretion of the management." I.R.C. § 808(b)(1).[16] This Court finds that § 808(b)(1) does not include the present distributions because, although their amounts are not fixed in the con-

---

demptions and exchanges. *See supra* Section II.A.; I.R.C. §§ 302(b)(3), 351(a). Notwithstanding Plaintiffs' contention, then, this Court infers the spirit of § 808(a) to be in harmony with its letter and gives effect to both.

[16] Section 808(b)(1) of the Code provides:

> § 808. Policyholder dividends deduction
>
> (b) Certain amounts included.—For purposes of this part, the term "policyholder dividend" includes—
>
> (1) any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management.

tract, their amounts do not depend on the experience of the company or the discretion of the management.

1. Is the Amount of Either Distribution "Fixed in the Contract"?

Plaintiffs first contend that the amounts of the distributions in this case are "not fixed in the contract." A distribution amount is 'fixed in the contract" when policy contract provisions both fix the distribution amount, such as by formula, and legally oblige the insurance company to make the distribution. *Prairie States Life Ins. Co. v. United States*, 828 F.2d 1222, 1227 (8th Cir. 1987). There are no policy contract provisions governing the distribution amounts in this case. This Court, therefore, finds that those distribution amounts are "not fixed in the contract."

Plaintiffs then argue that this Court's finding that the distribution amounts are "not fixed in the contract" suffices alone to include the distributions within § 808(b)(1), for that finding implies a corresponding finding that the distribution amounts either "depend[] on the experience of the company or the discretion of the management." Plaintiffs' Reply Brief at 9. In support of this argument, Plaintiffs cite *dicta* from *American National Insurance Co. v. United States*, 690 F.2d 878 (Ct.Cl.1982), suggesting that these latter two elements of the § 808(b)(1) definition "may not have independent significance" and "seem to be opposite sides of the same coin, in the sense that the inquiry is whether the amounts are either fixed in the contract or depend upon [experience or discretion]." *Id.* at 886.

This Court is not persuaded to read these latter two elements of the § 808(b)(1) definition out of the statute by needlessly denying their "independent significance." Indeed, far from being superfluous, the question of whether the amount depends on company experience or management discretion constitutes the primary inquiry

under § 808(b)(1).[17] The subsidiary inquiry of whether the amount is fixed in the contract facilitates, but cannot substitute entirely for, the primary inquiry; the subsidiary inquiry serves only to exclude from the primary inquiry an easily identified category of distributions that invariably fail the primary inquiry.

In other words, if a distribution amount is "fixed in the contract," it categorically cannot "depend[] on the experience of the company or the discretion of the management." If, however, a distribution amount is "*not* fixed in the contract," it may or may not "depend[] on the experience of the company or the discretion of the management." Only certain distributions have their amounts "fixed in the contract"; within the otherwise boundless residual category (*i.e.*, "not fixed in the contract"), only certain distributions depend on either company experience or management discretion.

The *American National* court's *dicta*, then, were appropriate to the facts before it because the distributions there were fixed in the contract. *See American Nat'l*, 690 F.2d at 886 ("Since we hold that the amounts . . . were fixed by the contract, it follows that they did not depend upon the experience of the company or the discretion of the management.") Those *dicta*, by contrast, are not appropriate to the facts before this Court because the amounts here are *not* fixed in the contract. Therefore, the questions of whether the distribution amounts depend on company experience or on management discretion remain open. This Court now turns to those questions.

---

[17] The clearest indication of the indispensability and primacy of the company-experience-or-management-discretion inquiry is Congress's use of the conjunctive "but" to introduce it. To accept Plaintiffs' reading of that inquiry as dispensable and equivalent to the not-fixed-in-the-contract inquiry is effectively to amend that conjunctive "but" to the disjunctive "or."

2. Does the Amount of Either Distribution "Depend[] on the Experience of the Company"?

Plaintiffs claim that the amounts of both distributions "depend on the experience of the company." "Experience of the company" refers only to company-specific profit and loss experience, not industry-wide actuarial experience. *Republic Nat'l Life Ins. Co. v. United States*, 594 F.2d 530, 534-35 (5th Cir.1979). More specifically, the relevant profit and loss experience is limited to the company's "experience in the particular year for which the refunds are made, not its overall past experience and history." *American Nat'l*, 690 F.2d at 886. Here, the distribution amounts are based on Union Mutual's profit and loss experience for the entire history of the company since 1848, not for the particular year in which the distributions are made. Therefore, the distribution amounts do not depend on the "experience of the company."

3. Does the Amount of Either Distribution "Depend[] . . . on the Discretion of the Management"?

Plaintiffs argue, in the alternative, that the distribution amounts in this case "depend on the discretion of the management." The term "discretion of the management" does not include the limited form of discretion that management necessarily exercises in designing any general formula for fixing distribution amounts. *American Nat'l*, 690 F.2d at 887. Here, that limited form of discretion is the only form that Union Mutual's management could even colorably have exercised. Indeed, the decisionmaking power of Union Mutual's management regarding the formula for determining Equity Shares is so thoroughly circumscribed that it can hardly be called "discretion" at all. More specifically, the design of the formula, along with the rest of the Plan, was subject both to the requirements of Maine insurance law as implemented by the Maine Superintendent of Insurance and to a supermajority vote

of policyholders. *See* Plan at A-3. The distribution amounts, therefore, do not depend on the "discretion of the management." Nor, then, do the distributions fit within § 808(b)(1).

III. CONCLUSION

Section 808 defines "policyholder dividend" as "any dividend or similar distribution to policyholders in their capacity as such," including "any amount paid or credited . . . [that] is not fixed in the contract but depends on the experience of the company or the discretion of the management." I.R.C. §§ 808(a), 808(b)(1). Plaintiffs urge this Court to read that definition, in effect, as "any distribution to policyholders that is not fixed in the contract," while the Government urges that it be read as "any dividend-like distribution to policyholders that depends on company experience or management discretion, which categorically does not include those fixed in the contract." This Court finds that the Government's interpretation of "policyholder dividend" provides a more nearly comprehensive account of all relevant statutory language, and so provides a more nearly adequate account of the intention that Congress sought to embody in that language.

This Court further finds that the distributions of cash and stock in this case do not fit within the reading of "policyholder dividend" accepted by the Court. Those distributions are not "dividend-like" both because policyholders obtained them in exchange for property of equivalent value and because policyholders obtained them in exchange for the surrender of all their proportional interests in Union Mutual. Because the distribution amounts are not "fixed in the contract," the question of whether they "depend on company experience or management discretion" is not summarily answered in the negative. That question is ultimately answered in the negative, however, because the distributions do not fall within the meaning of "company experience" or "management discretion" as

those terms have been interpreted. Therefore, neither the cash nor the stock distribution is deductible to Plaintiffs under § 805(a)(3).

Accordingly, it is hereby *ORDERED* that judgment herein be, and it is hereby, *ENTERED* in favor of the Defendant, United States of America, on all claims set forth in the Complaint.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

No. 96-1877

UNUM CORPORATION AND UNUM LIFE INSURANCE COMPANY OF AMERICA,
Plaintiff, Appellant,

v.

UNITED STATES OF AMERICA,
Defendant, Appellee.

JUDGMENT
Entered: December 2, 1997

This cause came on to be heard on appeal from the United States District Court for the District of Maine, and was argued by counsel.

Upon consideration whereof, it is now here ordered, adjudged and decreed as follows: The judgment of the district court is affirmed. Costs of appellees.

BY THE COURT:

/s/ Phoebe Morse
PHOEBE MORSE
Clerk

By: /s/ _____
Chief Deputy Clerk

APPENDIX D

SUPREME COURT OF THE UNITED STATES
OFFICE OF THE CLERK
WASHINGTON, DC 20543-0001

WILLIAM K. SUTER
Clerk of the Court

Area Code 202
479-3011

February 5, 1998

Mr. John G. Roberts Jr.
Hogan & Hartson
555 Thirteenth Street, N.W.
Washington, DC 20004

Re: UNUM Corporation and UNUM Life Insurance Company of America
v. United States
Application No. A-572

Dear Mr. Roberts;

The application for an extension of time within which to file a petition for a writ of certiorari in the above-entitled case has been presented to Justice Souter, who on February 5, 1998, extended the time to and including April 16, 1998.

This letter has been sent to those designated on the attached notification list.

Sincerely,

WILLIAM K. SUTER
Clerk

By /s/ Jeffrey D. Atkins
JEFFREY D. ATKINS
Assistant Clerk

APPENDIX E

PERTINENT STATUTORY AND REGULATORY PROVISIONS

26 U.S.C. § 118(a) provides:

Contributions to the capital of a corporation

(a) General rule.—In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

* * * *

26 U.S.C. § 316 provides in pertinent part:

Dividend defined

(a) General rule.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

(b) Special rules.—

(1) Certain insurance company dividends.—The definition in subsection (a) shall not apply to the term "dividend" as used in subchapter L in any case

where the reference is to dividends of insurance companies paid to policyholders as such.

* * * *

26 U.S.C. § 803 provides:

Life insurance gross income

(a) In general.—For purposes of this part, the term "life insurance gross income" means the sum of the following amounts:

(1) Premiums.—

(A) The gross amount of premiums and other consideration on insurance and annuity contracts, less

(B) return premiums, and premiums and other consideration arising out of indemnity reinsurance.

(2) Decreases in certain reserves.—Each net decrease in reserves which is required by section 807(a) to be taken into account under this paragraph.

(3) Other amounts.—All amounts not includible under paragraph (1) or (2) which under this subtitle are includible in gross income.

(b) Special rules for premiums.—

(1) Certain items included.—For purposes of subsection (a)(1)(A), the term "gross amount of premiums and other consideration" includes—

(A) advance premiums,

(B) deposits,

(C) fees,

(D) assessments,

(E) consideration in respect of assuming liabilities under contracts not issued by the taxpayer, and

(F) the amount of policyholder dividends reimbursable to the taxpayer by a reinsurer in respect of reinsured policies,

on insurance and annuity contracts.

(2) Policyholder dividends excluded from return premiums.—For purposes of subsection (a)(1)(B)—

(A) In general.—Except as provided in subparagraph (B), the term "return premiums" does not include any policyholder dividends.

(B) Exception for indemnity reinsurance.—Subparagraph (A) shall not apply to amounts of premiums or other consideration returned to another life insurance company in respect of indemnity reinsurance.

* * * *

26 U.S.C. § 805 provides:

General deductions

(a) General rule.—For purposes of this part, there shall be allowed the following deductions:

(1) Death benefits, etc.—All claims and benefits accrued, and all losses incurred (whether or not ascertained), during the taxable year on insurance and annuity contracts.

(2) Increases in certain reserves.—The net increase in reserves which is required by section 807(b) to be taken into account under this paragraph.

(3) Policyholder dividends.—The deduction for policyholder dividends (determined under section 808(c)).

(4) Dividends received by company.—

(A) In general.—The deductions provided by section 243, 244, and 245 (as modified by subparagraph (B))—

(i) for 100 percent dividends received, and

(ii) for the life insurance company's share of the dividends (other than 100 percent dividends) received.

(B) Application of section 246(b).—In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of subparagraph (A), the limit on the aggregate amount of the deductions allowed by sections 243(a)(1), 244(a), and 245 shall be the percentage determined under section 246(b)(3) of the life insurance company taxable income (and such limitation shall be applied as provided in section 246(b)(3)), computed without regard to—

(i) the small life insurance company deduction,

(ii) the operations loss deduction provided by section 810,

(iii) the deductions allowed by sections 243(a)(1), 244(a), and 245, and

(iv) any capital loss carryback to the taxable year under section 1212(a)(1),

but such limit shall not apply for any taxable year for which there is a loss from operations.

(C) 100 percent dividend.—For purposes of subparagraph (A)—

(i) In general.—Except as provided in clause (ii), the term "100 percent dividend" means any dividend if the percentage used for purposes of determining the deduction allowable under section 243, 244, or 245(b) is 100 percent.

(ii) Treatment of dividends from non-insurance companies.—The term "100 percent dividend" does not include any distribution by a corporation which is not an insurance company to the extent such distribution is out of tax-exempt interest, or out of the increase for the taxable year in policy cash values (within the meaning of subparagraph (F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies, or out of dividends which are not 100 percent dividends (determined with the application of this clause as if it applies to distributions by all corporations including insurance companies).

(D) Special rules for certain dividends from insurance companies.—

(i) In general.—In the case of any 100 percent dividend paid to any life insurance company out of the earnings and profits for any taxable year beginning after December 31, 1983, of another life insurance company if—

(I) the paying company's share determined under section 812 for such taxable year, exceeds

(II) the receiving company's share determined under section 812 for its taxable year in which the dividend is received or accrued,

the deduction allowed under section 243, 244, or 245(b) (as the case may be) shall be reduced as provided in clause (ii).

(ii) Amount of reduction.—The reduction under this clause for a dividend is an amount equal to—

(I) the portion of such dividend attributable to prorated amounts, multiplied by

(II) the percentage obtained by subtracting the share described in subclause (II) of clause (i) from the share described in subclause (I) of such clause.

(iii) Prorated amounts.—For purposes of this subparagraph, the term "prorated amounts" means tax-exempt interest, the increase for the taxable year in policy cash values (within the meaning of subparagraph (F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies, and dividends other than 100 percent dividends.

(iv) Portion of dividend attributable to prorated amounts.—For purposes of this subparagraph, in determining the portion of any dividend attributable to prorated amounts—

(I) any dividend by the paying corporation shall be treated as paid first out of earnings and profits for taxable years beginning after December 31, 1983, attributable to prorated amounts (to the extent thereof), and

(II) by determining the portion of earnings and profits so attributable without any reduction for the tax imposed by this chapter.

(v) Subparagraph to apply to dividends from other insurance companies.—Rules similar to the rules of this subsection shall apply in the case of 100 percent dividends paid by an insurance company which is not a life insurance company.

(E) Certain dividends received by foreign corporations.—Subparagraph (A)(i) (and not subparagraph (A)(ii)) shall apply to any dividend received by a foreign corporation from a domestic corporation which would be a 100 percent dividend if section 1504(b)(3) did not apply for purposes of applying section 243 (b)(2).

(F) Increase in policy cash values.—For purposes of subparagraphs (C) and (D)—

(i) In general.—The increase in the policy cash value for any taxable year with respect to policy or contract is the amount of the increase in the adjusted cash value during such taxable year determined without regard to—

(I) gross premiums paid during such taxable year, and

(II) distributions (other than amounts includible in the policyholder's gross income) during such taxable year to which section 72(e) applies.

(ii) Adjusted cash value.—For purposes of clause (i), the term "adjusted cash value" means the cash surrender value of the policy or contract increased by the sum of—

(I) commissions payable with respect to such policy or contract for the taxable year, and

(II) asset management fees, surrender charges, mortality and expense charges, and any other fees or charges specified in regulations prescribed by the Secretary which are imposed (or which would be imposed were the policy or contract canceled) with respect to such policy or contract for the taxable year.

(5) Operations loss deduction.—The operations loss deduction (determined under section 810).

(6) Assumption by another person of liabilities under insurance, etc., contracts.—The consideration (other than consideration arising out of indemnity reinsurance) in respect of the assumption by another person of liabilities under insurance and annuity contracts.

(7) Reimbursable dividends.—The amount of policyholder dividends which—

(A) are paid or accrued by another insurance company in respect of policies the taxpayer has reinsured, and

(B) are reimbursable by the taxpayer under the terms of the reinsurance contract.

(8) Other deductions.—Subject to the modification provided by subsection (b), all other deductions allowed under this subtitle for purposes of computing taxable income.

Except as provided in paragraph (3), no amount shall be allowed as a deduction under this part in respect of policyholder dividends.

(b) Modifications.—The modifications referred to in subsection (a)(8) are as follows:

(1) Interest.—In applying section 163 (relating to deduction for interest), no deduction shall be allowed for interest in respect of items described in section 807(c).

(2) Charitable, etc., contributions and gifts.—In applying section 170—

(A) the limit on the total deductions under such section provided by section 170(b)(2) shall be 10 percent of the life insurance company taxable income computed without regard to—

(i) the deduction provided by section 170,

(ii) the deductions provided by paragraphs (3) and (4) of subsection (a),

(iii) the small life insurance company deduction,

(iv) any operations loss carryback to the taxable year under section 810, and

(v) any capital loss carryback to the taxable year under section 1212(a)(1), and

(B) under regulations prescribed by the Secretary, a rule similar to the rule contained in section 170(d)(2)(B) (relating to special rule for net operating loss carryovers) shall be applied.

(3) Amortizable bond premium.—

(A) In general.—Section 171 shall not apply.

(B) Cross reference.—

For rules relating to amortizable bond premium, see section 811(b).

(4) Net operating loss deduction.—Except as provided by section 844, the deduction for net operating losses provided in section 172 shall not be allowed.

(5) Dividends received deduction.—Except as provided in subsection (a)(4), the deductions for dividends received provided by sections 243, 244, and 245 shall not be allowed.

* * * *

26 U.S.C. § 808 provides:

Policyholder dividends deduction

(a) Policyholder dividend defined.—For purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.

(b) Certain amounts included.—For purposes of this part, the term "policyholder dividend" includes—

(1) any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management.

(2) excess interest,

(3) premium adjustments, and

(4) experience-rated refunds.

(c) Amount of deduction.—

(1) In general.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.

(2) Reduction in case of mutual companies.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809.

(d) Definitions.—For purposes of this section—

(1) Excess interest.—The term "excess interest" means any amount in the nature of interest—

(A) paid or credited to a policyholder in his capacity as such, and

(B) in excess of interest determined at the prevailing State assumed rate for such contract.

(2) Premium adjustment.—The term "premium adjustment" means any reduction in the premium under an insurance or annuity contract which (but for the reduction) would have been required to be paid under the contract.

(3) Experience-rated refund.—The term "experience-rated refund" means any refund or credit based on the experience of the contract or group involved.

(e) Treatment of policyholder dividends.—For purposes of this part, any policyholder dividend which—

(1) increases the cash surrender value of the contract or other benefits payable under the contract, or

(2) reduces the premium otherwise required to be paid,

shall be treated as paid to the policyholder and returned by the policyholder to the company as a premium.

(f) Coordination of 1984 fresh-start adjustment with acceleration of policyholder dividends deduction through change in business practice.—

(1) In general.—The amount determined under paragraph (1) of subsection (c) for the year of

change shall (before any reduction under paragraph (2) of subsection (c)) be reduced by so much of the accelerated policyholder dividends deduction for such year as does not exceed the 1984 fresh-start adjustment for policyholder dividends (to the extent such adjustment was not previously taken into account under this subsection).

(2) Year of change.—For purposes of this subsection, the term "year of change" means the taxable year in which the change in business practices which results in the accelerated policyholder dividends deduction takes effect.

(3) Accelerated policyholder dividends deduction defined.—For purposes of this subsection, the term "accelerated policyholder dividends deduction" means the amount which (but for this subsection) would be determined for the taxable year under paragraph (1) of subsection (c) but which would have been determined (under such paragraph) for a later taxable year under the business practices of the taxpayer as in effect at the close of the preceding taxable year.

(4) 1984 fresh-start adjustment for policyholder dividends.—For purposes of this subsection, the term "1984 fresh-start adjustment for policyholder dividends" means the amounts held as of December 31, 1983, by the taxpayer as reserves for dividends to policyholders under section 811(b) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1984) other than for dividends which accrued before January 1, 1984. Such amounts shall be properly reduced to reflect the amount of previously nondeductible policyholder dividends (as determined under section 809(f) as in effect on the day before the date of the enactment of the Tax Reform Act of 1984).

(5) Separate application with respect to lines of business.—This subsection shall be applied sepa-

rately with respect to each line of business of the taxpayer.

(6) Subsection not to apply to mere change in dividend amount.—This subsection shall not apply to a mere change in the amount of policyholder dividends.

(7) Subsection not to apply to policies issued after December 31, 1983.—

(A) In general.—This subsection shall not apply to any policyholder dividend paid or accrued with respect to a policy issued after December 31, 1983.

(B) Exchanges of substantially similar policies.—For purposes of subparagraph (A), any policy issued after December 31, 1983, in exchange for a substantially similar policy issued on or before such date shall be treated as issued before January 1, 1984. A similar rule shall apply in the case of a series of exchanges.

(8) Subsection to apply to policies provided under employee benefit plans.—This subsection shall not apply to any policyholder dividend paid or accrued with respect to a group policy issued in connection with a plan to provide welfare benefits to employees (within the meaning of section 419(e)(2)).

* * * *

26 U.S.C. § 809 provides:

Redution in certain deductions of mutual life insurance companies

(a) General rule.—

(1) Policyholder dividends.—In the case of any mutual life insurance company, the amount of the deduction allowed under section 808 shall be reduced

(but not below zero) by the differential earnings amount.

(2) Reduction in reserve deduction in certain cases.—In the case of any mutual life insurance company, if the differential earnings amount exceeds the amount allowable as a deduction under section 808 for the taxable year (determined without regard to this section), such excess shall be taken into account under subsections (a) and (b) of section 807.

(3) Differential earnings amount.—For purposes of this section, the term "differential earnings amount" means, with respect to any taxable year, an amount equal to the product of—

(A) the life insurance company's average equity base for the taxable year, multiplied by

(B) the differential earnings rate for such taxable year.

(b) Average equity base.—For purposes of this section—

(1) In general.—The term "average equity base" means, with respect to any taxable year, the average of—

(A) the equity base determined as of the close of the taxable year, and

(B) the equity base determined as of the close of the preceding taxable year.

(2) Equity base.—The term "equity base" means an amount determined in the manner prescribed by regulations equal to—

(A) the surplus and capital,

(B) adjusted as provided in paragraphs (3), (4), (5), and (6) of this subsection.

No item shall be taken into account more than once in determining equity base.

(3) Increase for nonadmitted financial assets.—

(A) In general.—The amount of the surplus and capital shall be increased by the amount of the nonadmitted financial assets.

(B) Nonadmitted financial assets.—For purposes of subparagraph (A), the term "nonadmitted financial asset" means any nonadmitted asset of the company which is—

(i) a bond,

(ii) stock,

(iii) real estate,

(iv) a mortgage loan on real estate, or

(v) any other invested asset.

(4) Increase where statutory reserves exceed tax reserves.—

(A) In general.—If—

(i) the aggregate amount of statutory reserves, exceeds

(ii) the aggregate amount of tax reserves,

the amount of the surplus and capital shall be increased by the amount of such excess.

(B) Definitions.—For purposes of this paragraph—

(i) Statutory reserves.—The term "statutory reserves" means the aggregate amount set forth in the annual statement with respect to items described in section

807(c). Such term shall not include any reserve attributable to a deferred and uncollected premium if the establishment of such reserve is not permitted under section 811(c).

(ii) Tax reserves.—The term "tax reserves" means the aggregate of the items described in section 807(c) as determined for purposes of section 807.

(5) Increase by amount of certain other reserves.—The amount of the surplus and capital shall be increased by the sum of—

(A) the amount of any mandatory securities valuation reserve,

(B) the amount of any deficiency reserve, and

(C) the amount of any voluntary reserve or similar liability not described in subparagraph (A) or (B).

(6) Adjustment for next year's policyholder dividends.—The amount of the surplus and capital shall be increased by 50 percent of the amount of any provision for policyholder dividends (or other similar liability) payable in the following taxable year.

(c) Differential earnings rate.—

(1) In general.—For purposes of this section, the differential earnings rate for any taxable year is the excess of—

(A) the imputed earnings rate for the taxable year, over

(B) the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

(2) Transitional rule.—The differential earnings rate—

(A) for any taxable year beginning in 1984, or

(B) for purposes of computing the amount of underpayment under section 6655 (including the application of section 6655(d)(3)) for any taxable year beginning in 1985,

shall be equal to 7.8 percent.

(3) Coordination with estimated tax payments.—For purposes of applying section 6655 with respect to any installment of estimated tax, the amount of tax shall be determined by using the lesser of—

(A) the differential earnings rate of the second tax year preceding the taxable year for which the installment is made, or

(B) the differential earnings rate for the taxable year for which the installment is made.

(d) Imputed earnings rate.—

(1) In general.—For purposes of this section, the imputed earnings rate for any taxable year is—

(A) 16.5 percent in the case of taxable years beginning in 1984, and

(B) in the case of taxable years beginning after 1984, an amount which bears the same ratio to 16.5 percent as the current stock earnings rate for the taxable year bears to the base period stock earnings rate.

(2) Current stock earnings rate.—For purposes of this subsection, the term "current stock earnings rate" means, with respect to any taxable year, the average of the stock earnings rates determined under paragraph (4) for the 3 calendar years preceding the calendar year in which the taxable year begins.

(3) Base period stock earnings rate.—For purposes of this subsection, the base period stock earnings rate is the average of the stock earnings rates determined under paragraph (4) for calendar years 1981, 1982, and 1983.

(4) Stock earnings rate.—

(A) In general.—For purposes of this subsection, the stock earnings rate for any calendar year is the numerical average of the earnings rates of the 50 largest stock companies.

(B) Earnings rate.—For purposes of subparagraph (A), the earnings rate of any stock company is the percentage (determined by the Secretary) which—

(i) the statement gain or loss from operations for the calendar year of such company, is of

(ii) such company's average equity base for such year.

(C) 50 largest stock companies.—For purposes of this paragraph, the term "50 largest stock companies" means a group (as determined by the Secretary) of stock life insurance companies which consists of the 50 largest domestic stock life insurance companies which are subject to tax under this part. The Secretary—

(i) shall, for purposes of determining the base period stock earnings rate, exclude from the group determined under the preceding sentence any company which had a negative equity base at any time during 1981, 1982, or 1983.

(ii) shall exclude from such group for any calendar year any company which has a negative equity base, and

(iii) may by regulations exclude any other company which otherwise would have been included in such group if the inclusion of the excluded company or companies would, by reason of the small equity base of such company, seriously distort the stock earnings rate.

The aggregate number of companies excluded by the Secretary under clause (iii) shall not exceed the excess of 2 over the number of companies excluded under clause (ii).

(D) Treatment of affiliated groups.—For purposes of this paragraph, all stock life insurance companies which are members of the same affiliated group shall be treated as one stock life insurance company.

(e) Average mutual earnings rate.—For purposes of this section, the average mutual earnings rate for any calendar year is the percentage (determined by the Secretary) which—

(1) the aggregate statement gain or loss from operations for such year of domestic mutual life insurance companies, is of

(2) their aggregate average equity bases for such year.

(f) Recomputation in subsequent year.—

(1) Inclusion in income where recomputed amount greater.—In the case of any mutual life insurance company, if—

(A) the recomputed differential earnings amount for any taxable year, exceeds

(B) the differential earnings amount determined under this section for such taxable year,

such excess shall be included in life insurance gross income for the succeeding taxable year.

(2) Deduction where recomputed amount smaller.—In the case of any mutual life insurance company, if—

(A) the differential earnings amount determined under this section for any taxable year, exceeds

(B) the recomputed differential earnings amount for such taxable year,

such excess shall be allowed as a life insurance deduction for the succeeding taxable year.

(3) Recomputed differential earnings amount.—For purposes of this subsection, the term "recomputed differential earnings amount" means, with respect to any taxable year, the amount which would be the differential earnings amount for such taxable year if the average mutual earnings rate taken into account under subsection (c)(1)(B) were the average mutual earnings rate for the calendar year in which the taxable year begins.

(4) Special rule where company ceases to be mutual life insurance company.—Except as provided in section 381(c)(22), if—

(A) a life insurance company is a mutual life insurance company for any taxable year, but

(B) such life insurance company is not a mutual life insurance company for the succeeding taxable year,

any adjustment under paragraph (1) or (2) by reason of the recomputed differential earnings amount for the first of such taxable years shall be taken into account for the first of such taxable years.

(5) Subsection not to apply for purposes of estimated tax.—Section 6655 shall be applied to any

taxable year without regard to any adjustments under this subsection for such year.

(g) Definitions and special rules.—For purposes of this section—

(1) Statement gain or loss from operations.—The term "statement gain or loss from operations" means the net gain or loss from operations required to be set forth in the annual statement, determined without regard to Federal income taxes, and—

(A) determined by substituting for the amount shown for policyholder dividends the amount of deduction for policyholder dividends determined under section 808 (without regard to section 808(c)(2)),

(B) determined on the basis of the tax reserves rather than statutory reserves, and

(C) properly adjusted for realized capital gains and losses and other relevant items.

(2) Other terms.—Except as otherwise provided in this section, the terms used in this section shall have the same respective meanings as when used in the annual statement.

(3) Determinations based on amount set forth in annual statement.—Except as otherwise provided in this section or in regulations, all determinations under this section shall be made on the basis of the amounts required to be set forth on the annual statement.

(4) Annual statement.—The term "annual statement" means the annual statement for life insurance companies approved by the National Association of Insurance Commissioners.

(5) Reduction in equity base for portion of equity allocable to life insurance business in noncontiguous

western hemisphere countries.—The equity base of any mutual life insurance company shall be reduced by an amount equal to the portion of the equity base attributable to the life insurance business multiplied by a fraction—

(A) the numerator of which is the portion of the tax reserves which is allocable to life insurance contracts issued on the life of residents of countries in the Western Hemisphere which are not contiguous to the United States, and

(B) the denominator of whih is the amount of the tax reserves allocable to life insurance contracts.

The preceding sentence shall not apply unless the fraction determined under the preceding sentence exceeds 1/20.

(6) Special rule for certain contracts issued before January 1, 1985.—In determining the amount of tax reserves of a subsidiary of a mutual insurance company for purposes of subsection (b)(4), section 811 (d) shall not apply with respect to any life insurance contract issued before January 1, 1985, under a plan of life insurance in existence on July 1, 1983.

(h) Treatment of stock companies owned by mutual life insurance companies.—

(1) Treatment as mutual life insurance companies for purposes of determining stock earnings rates and mutual earnings rates.—Solely for purposes of subsections (d) and (e), a stock life insurance company shall be treated as a mutual life insurance company if stock possessing—

(A) at least 80 percent of the total combined voting power of all classes of stock of such stock life insurance company entitled to vote, or

(B) at least 80 percent of the total value of shares of all classes of stock of such stock life insurance company,

is owned at any time during the calendar year directly (or through the application of section 318) by one or more mutual life insurance companies.

(2) Treatment of affiliated group which includes mutual parent and stock subsidiary.—In the case of an affiliated group of corporations which includes a common parent which is a mutual life insurance company and one or more stock life insurance companies, for purposes of determining the average equity base of such common parent (and the statement gain or loss from operations)—

(A) stock in such stock life insurance companies held by such common parent (and dividends on such stock) shall not be taken into account, and

(B) such common parent and such stock life insurance companies shall be treated as though they were one mutual life insurance company.

(3) Adjustment where stock company not member of affiliated group.—In the case of any stock life insurance company which is described in paragraph (1) but is not a member of an affiliated group described in paragraph (2), under regulations, proper adjustments shall be made in the average equity bases (and statement gains or losses from operations) of mutual life insurance companies owning stock in such company as may be necessary or appropriate to carry out the purposes of this section.

(i) Transitional rule for certain high surplus mutual life insurance companies.—

(1) In general.—For purposes of subsection (a)(3), the average equity base of a high surplus mutual life insurance company for any taxable year shall not

include the applicable percentage of the excess equity base of such company for such taxable year.

(2) Definitions.—For purposes of this subsection—

(A) Excess equity base.—The term "excess equity base" means the excess of—

(i) the average equity base of the company for the taxable year, over

(ii) the amount which would be its average equity base if its equity percentage equaled the following percentage:

For taxable years beginning in:	The percentage is:
1984	14.5
1985 or 1986	14
1987 or 1988	13.5

In no case shall the excess equity base for any taxable year be greater than the excess equity base for the company's first taxable year beginning in 1984.

(B) Applicable percentage.—The term "applicable percentage" means the percentage determined in accordance with the following table:

For taxable years beginning in:	The applicable percentage is:
1984	100
1985	80
1986	60
1987	40
1988	20
1989 or thereafter	0.

(C) High surplus mutual life insurance company.—The term "high surplus mutual life in surance company" means any mutual life insur-

ance company if, for the taxable year beginning in 1984, its equity percentage exceeded 14.5 percent.

(D) Equity percentage.—The term "equity percentage" means, with respect to any mutual life insurance company, the percentage which—

(i) the average equity base of such company (determined under this section without regard to this subsection) for a taxable year bears to

(ii) the average of—

(I) the assets of such company as of the close of the preceding taxable year, and

(II) the assets of such company as of the close of the taxable year.

For purposes of the preceding sentence, the assets of a company shall include all assets taken into account under this section in determining its equity base (after applying the principles of subsection (h)).

* * * *

26 U.S.C. § 1032 provides:

Exchange of stock for property

(a) Nonrecognition of gain or loss.—No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation. No gain or loss shall be recognized by a corporation with respect to any lapse or acquisition of an option to buy or sell its stock (including treasury stock).

(b) Basis.—

For basis of property acquired by a corporation in certain exchanges for its stock, see section 362.

* * * *

Treasury Regulation § 1.811-2(a) (1961) provides:

(a) Dividends to policyholders defined. Section 811 (a) defines the term "dividends to policyholders" for purposes of Part I, Subchapter L, Chapter 1 of the Code, to mean dividends and similar distributions to policyholders in their capacity as such. The term includes amounts returned to policyholders where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management. In general, any payment not fixed in the contract which is made with respect to a participating contract (that is, a contract which during the taxable year contains a right to participate in the divisible surplus of the company) shall be treated as a dividend to policyholders. Similarly, any amount refunded or allowed as a rate credit with respect to either a participating or a nonparticipating contract shall be treated as a dividend to policyholders if such amount depends on the experience of the company. However, the term does not include interest paid (as defined in section 805(e) and paragraph (b) of § 1.805-8) or return premiums (as defined in section 809(c) and paragraph (a)(1)(ii) of § 1.809-4). Thus, so-called excess-interest dividends and amounts returned by one life insurance company to another in respect of reinsurance ceded shall not be treated as dividends to policyholders even though such amounts are not fixed in the contract but depend upon the experience of the company or the discretion of the management.

* * * *

Supreme Court, U.S.
FILED
JUN 15 1998
CLERK

(2)

No. 97-1679

In the Supreme Court of the United States

OCTOBER TERM, 1997

UNUM CORPORATION AND UNUM LIFE INSURANCE COMPANY OF AMERICA, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

SETH P. WAXMAN
Solicitor General
Counsel of Record
LORETTA C. ARGRETT
Assistant Attorney General
DAVID I. PINCUS
EDWARD T. PERELMUTER
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

22 pp

QUESTION PRESENTED

Whether the transfer of stock and cash to policyholders of a mutual insurance company to extinguish their membership interests in that company constitutes a deductible "policyholder dividend" under Section 808 of the Internal Revenue Code, 26 U.S.C. 808.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	8
Conclusion	18

TABLE OF AUTHORITIES

Cases:

Burnet v. *Harmel*, 287 U.S. 103 (1932)	13
Citizens Bank & Trust Co. v. *United States*, 580 F.2d 442 (Ct. Cl. 1978)	11
Colonial American Life Insurance Co. v. *Commissioner*, 491 U.S. 244(1989)	9, 15, 16
Commissioner v. *Pope*, 239 F.2d 881 (1st Cir. 1957)	11
Conroy v. *Aniskoff*, 507 U.S. 511 (1993)	12
Duffy v. *Mutual Benefits Life Insurance Co.*, 272 U.S. 613 (1926)	9
Hellmich v. *Hellman*, 276 U.S. 233 (1928)	10
Republic National Life Insurance Co. v. *United States*, 594 F.2d 530 (5th Cir. 1979)	15
Ruocco v. *Bateman, Eichler, Hill, Richards, Inc.*, 903 F.2d 1232 (9th Cir.), cert. denied, 498 U.S. 899 (1990)	13
United States National Bank of Oregon v. *Independent Insurance Agents of America, Inc.*, 508 U.S. 439 (1993)	12
United States v. *Davis*, 397 U.S. 301 (1970)	10
United States v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132 (1989)	17
United States v. *Hill*, 506 U.S. 546 (1993)	17
United States v. *Morton*, 467 U.S. 822 (1984)	12

Statutes and regulation: Page

Internal Revenue Code (26 U.S.C.):
§ 162(k) 8, 16
§ 302 5
§ 311(a) 8
§ 316 14
§ 316(a) 14
§ 316(b) 14
§ 351(a) 4, 5, 9
§ 368(a)(1)(E) 5, 9
§ 805 ..... 7, 10, 16
§ 805(a)(3) 6, 9, 10
§ 808 ..... 6, 7, 9, 10, 13, 15, 16
§ 808(a) 6, 7, 10, 11
§ 808(a)(1) 10
§ 808(b) 10, 14
§ 808(b)(1) 11, 12
§ 1032(a) 8
§ 7701(a)(3) 9
§ 7701(a)(7) 9
Treas. Reg. 1.811-2(a) (1961) 13

Miscellaneous:

S. Rep. No. 291, 86th Cong., 1st Sess. (1959) 9

In the Supreme Court of the United States

OCTOBER TERM, 1997

No. 97-1679

UNUM CORPORATION AND UNUM LIFE INSURANCE COMPANY OF AMERICA, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 61a) is reported at 130 F.3d 501. The opinion of the district court (Pet. App. 38a-60a) is reported at 929 F. Supp. 15.

JURISDICTION

The judgment of the court of appeals was entered on December 2, 1997. On February 5, 1998, Justice Souter extended the time for filing a petition for a writ of certiorari to April 16, 1998 (Pet. App. 62a). The petition for a writ of certiorari was filed on April 14, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. Petitioner UNUM Life Insurance Company is the successor to Union Mutual Life Insurance Company. Prior to 1986, Union Mutual was a mutual insurance company incorporated under the laws of the State of Maine (Pet. App. 5a). As a mutual insurance company, Union Mutual was owned by its policyholders, who held voting rights in the company, were entitled to share in its surplus upon liquidation and possessed preemptive rights in the event the company converted to a stock company (*id.* at 5a & n.1).

In 1984, Union Mutual decided to "demutualize," which is the term employed to describe the conversion from a mutual insurance company to a stock insurance company (Pet. App. 5a-6a). The primary reason for doing so was to provide access for the company to capital sources other than its policyholders. The company submitted a proposed plan of conversion for approval by the Maine Superintendent of Insurance.[1] The Superintendent approved an

---

[1] The applicable Maine statute specifies various conditions that the plan of conversion must satisfy to receive approval by the Superintendent. The statute requires, *inter alia*, (i) that the terms of the plan be fair and equitable, (ii) that the "equity share" of each "member" of the insurer (as defined in (v) below) be determinable by the Superintendent under a fair and reasonable formula based upon the insurer's entire surplus as shown by its financial statements, (iii) that the plan give each member of the insurer a preemptive right to acquire his proportionate part of the proposed capital stock of the stock company, (iv) that the plan provide for payment to each member of his entire equity share in the insurer, with the payment to be made in cash or stock of the stock company, and (v) that the "members" entitled to receive stock or cash include all policyholders within three years prior to the date

amended plan for the demutualization of Union Mutual on August 8, 1986 (*id.* at 6a).

The final plan of conversion provided for the creation of a holding company to own the stock of the new stock insurance company (Pet. App. 7a). Under the plan, the policyholders of the mutual insurance company were to transfer their "membership interests"[2] in the mutual insurance company to the holding company. In return, they were to receive stock of the holding company or, if they qualified as "cash option eligible policyholders," they could choose instead to receive cash from the mutual company (*ibid.*).[3] The holding company was then to exchange the membership interests it thus acquired in the mutual company for the shares of the new stock company (*ibid.*). To raise additional capital, the holding company was thereafter to issue and sell additional stock to the general public (*ibid.*).

The plan of conversion provided an actuarial formula for determining the consideration to be provided

---

the plan was submitted for approval to the Superintendent. See Pet. App. 6a.

[2] The plan of conversion generally defined the term "membership interest" as (Pet. App. 7a):

> all the rights or interests of each policy and contract holder of Union Mutual including, but not limited to, any right to vote, any rights which may exist with regard to the surplus of Union Mutual not apportioned by the Board for policyholder dividends, and any rights in liquidation or reorganization of Union Mutual * * *.

[3] Cash option policyholders were policyholders whose equity share was less than $2,500 (Pet. App. 7a n.3). Policyholders who received stock from the holding company were also to receive cash from the mutual company in lieu of fractional shares of stock.

to policyholders in exchange for their membership interests in Union Mutual (Pet. App. 8a). This figure, which was denominated the policyholder's "equity share," was defined as "the dollar amount of that part of Union Mutual's Adjusted Surplus attributable to" the particular policyholder (*ibid.*).[4] "Adjusted surplus" was the amount of surplus shown on the company's financial statement as of December 31, 1985, which was $652,050,097 (*ibid.*).

c. Before implementing the plan of conversion, Union Mutual requested a private letter ruling from the Internal Revenue Service concerning certain tax consequences of the conversion (Pet. App. 10a-11a). In particular, Union Mutual sought a ruling that the transfer by policyholders of membership interests in the mutual company for stock of the holding company would be treated as a tax-free "exchange" within the meaning of 26 U.S.C. 351(a) (Pet. App. 11a).[5] Union Mutual further requested a ruling that the proposed exchange of the equity interests received by the holding company for the common stock of the new

---

[4] The "equity share" reflected two components: (i) the relative contribution to statutory surplus made by eligible policyholders and (ii) the value of the intangible membership rights in the mutual company surrendered by the policyholders (Pet. App. 8a). These intangible rights were valued at $612.25 per equity share (*ibid.*).

[5] Section 351(a) provides that "[n]o gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation." 26 U.S.C. 351(a). Union Mutual requested the Section 351 ruling out of concern that its policyholders would otherwise be required to recognize gain (and therefore be subject to tax) on the exchange of equity interests.

stock company would be treated as a tax-free recapitalization under 26 U.S.C. 368(a)(1)(E) (Pet. App. 11a).

The Service responded with a private letter ruling addressing the tax consequences of the conversion. The ruling stated (i) that the transfer of membership interests in Union Mutual by eligible policyholders in exchange for stock of the holding company constituted an exchange within the meaning of 26 U.S.C. 351(a) and thus was not taxable to the policyholders and (ii) that the exchange of the membership interests in Union Mutual received by the holding company for the voting common stock of the new stock company constituted a tax-free recapitalization within the meaning of 26 U.S.C. 368(a)(1)(E) (Pet. App. 11a-12a). The ruling described the cash transferred to policyholders in exchange for their membership interests in Union Mutual as a nondeductible redemption of stock under 26 U.S.C. 302 (Pet. App. 12a).

d. In November 1996, Union Mutual implemented its plan of conversion to a stock company named UNUM Life Insurance Company (Pet. App. 10a). As part of that conversion, the newly-created holding company issued 20,489,072 shares of its stock to eligible policyholders in exchange for their membership interests in the mutual company (*ibid.*). The fair market value of the holding company's stock on the date of issuance was $25.20 per share. The total value of the shares received by policyholders was therefore $522,471,336 (*ibid.*). In addition, as part of the same conversion transaction, Union Mutual transferred cash in the amount of $129,129,082 to the eligible policyholders who elected cash redemption of their mutual shares (*ibid.*).

2. Petitioners filed a consolidated federal income tax return for 1986. On that return, petitioners did not claim a deduction for the value of the cash and stock that was transferred to policyholders as part of the conversion (Pet. App. 12a-13a). In 1992, however, petitioners filed an amended return in which they asserted that the cash transferred to policyholders ($129,738,478) constituted deductible "policyholder dividends" under 26 U.S.C. 805(a)(3) and 808 (Pet. App. 45a). Petitioners thereafter filed a second amended return in which they asserted that the fair market value of the stock transferred by the holding company to the former mutual shareholders ($522,471,336) was also a deductible "policyholder dividend" under those provisions (*ibid.*). When the Internal Revenue Service did not grant the refunds requested on the amended returns, petitioners filed this refund suit in district court (*ibid.*).

3. The district court held that petitioners were not entitled to the claimed deduction (Pet. App. 59a-60a).[6] The court concluded that the transfer of stock and cash to Union Mutual policyholders in exchange for their membership interests in the company constituted a redemption of stock and did not constitute a "policyholder dividend" under Section 808(a) of the Code (*ibid.*). The court noted that the statute defines the term "policyholder dividend" generally to mean

---

[6] Prior to ruling for the United States on the merits, the district court denied a motion for summary judgment filed by the government contending that principles of judicial estoppel and the duty of consistency precluded petitioners from claiming a policyholder dividends deduction with respect to the conversion. The petition (Pet. 9) erroneously implies that the district court's denial of the motion related to the merits of the case.

"any dividend or similar distribution to policyholders in their capacity as such" (26 U.S.C. 808(a)). The court explained that an amount received in exchange for a shareholder's proportional interest in a company, and in exchange for property of equivalent value, constitutes a redemption or exchange and not a "dividend" (Pet. App. 48a-53a). The court emphasized that petitioners had failed to produce any authority that defines the term "dividend" to include a transfer to a shareholder made in exchange for property of equivalent value (*id.* at 52a).

4. The court of appeals affirmed in a lengthy and detailed opinion (Pet. App. 1a-37a). The court noted that general corporate tax law applies to insurance companies in the absence of some specific provision to the contrary in the insurance tax section of the Internal Revenue Code (Subchapter L). Under general corporate tax principles, corporations are not allowed deductions for exchanges occurring with either shareholders or third-parties during the course of a corporate restructuring (Pet. App. 20a). The court concluded that this well-established general tax principle applies to the transaction involved here because nothing in Sections 805 and 808 of the Code clearly authorize a deduction for stock and cash transferred to policyholders in exchange for their membership interests in the course of a demutualization (*id.* at 14a, 25a-31a). The court held that petitioners had failed to establish "that the term 'policyholder dividend' under § 808(a) includes value-for-value exchanges that occur during a corporate reorganization such as this" (*id.* at 20a).

ARGUMENT

The court of appeals correctly concluded that petitioners are not entitled to a federal income tax deduction for the $652 million in stock and cash that they transferred in exchange for, and in redemption of, the rights of the policyholders in the mutual insurance company. The decision of the court of appeals does not conflict with any decision of this Court or any other court of appeals. Indeed, this case presents an issue of first impression. Further review is therefore not warranted.

1. a. As the court of appeals correctly recognized (Pet. App. 20a-24a), general corporate tax principles plainly bar petitioners from claiming a deduction for the value of the stock and cash transferred to policyholders in exchange for and redemption of their rights in the mutual insurance company. Section 162(k) of the Internal Revenue Code states clearly that a deduction is not allowed "for any amount paid or incurred by a corporation in connection with the reacquisition of its stock" (26 U.S.C. 162(k)). See also 26 U.S.C. 311(a) ("no gain or loss shall be recognized to a corporation on the distribution [of property] with respect to its stock"); 26 U.S.C. 1032(a) ("[n]o gain nor loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock * * * of such corporation").

In addition to the specialized provisions (in Subchapter L of the Code) that address specific features of taxation for insurance companies, insurers are subject to the general corporate tax provisions of the Internal Revenue Code. For example, when, as in the present case, an insurance company seeks to engage in a tax-free reorganization under the general pro-

visions of Sections 351(a) and 368(a)(1)(E) of the Code, "the general [corporate tax] rules of the Internal Revenue Code, such as the rules relating to (i) the characterization of income, (ii) the recognition or nonrecognition of gain upon sales or exchanges, reorganizations, etc. and (iii) the taxation of shareholders" apply "[e]xcept to the extent that specific provision is made [for insurance companies in Subchapter L]." S. Rep. No. 291, 86th Cong., 1st Sess. 39 (1959). See *Colonial American Life Insurance Co.* v. *Commissioner*, 491 U.S. 244, 253, 260 (1989).

Petitioners do not dispute that the provisions of the Internal Revenue Code that apply generally to all "corporations" are expressly applicable to "insurance companies" as well (26 U.S.C. 7701(a)(3)).[7] Instead, they contend that a "specific provision" has been made for insurance companies in Sections 805(a)(3) and 808 of the Code that permits those companies a deduction—not permitted to any other type of corporation—for the value of stock and cash transferred to shareholders.

---

[7] 26 U.S.C. 7701(a)(3) specifies that the term "corporation" for federal tax purposes "includes associations, joint-stock companies, and insurance companies." The statute further provides that "[t]he term 'stock' includes shares in an association, joint-stock company, or insurance company" (26 U.S.C. 7701(a)(7)) and that "[t]he term 'shareholder' includes a member in an association, joint-stock company, or insurance company" (26 U.S.C. 7701(a)(8)). This Court has long noted that the term "corporation" as used in the Internal Revenue Code "includes non-stock mutual insurance companies as well as those having capital stock" and that the term "shares" includes the membership interests of policyholders in a mutual insurance company. *Duffy* v. *Mutual Benefit Life Insurance Co.*, 272 U.S. 613, 616, 619-620 (1926).

b. Section 805(a)(3) of the Code allows a deduction for insurance companies for the amount of their "policyholder dividends" (26 U.S.C. 805(a)(3)). In Section 808(a) of the Code, the term "policyholder dividend" is defined to mean any "dividend or similar distribution to policyholders in their capacity as such" (26 U.S.C. 808(a)). As more particular examples, Section 808(b) further specifies that a "policyholder dividend" includes amounts paid or credited to policyholders "where the amount is not fixed in the [insurance] contract but depends on the experience of the company or the discretion of the management" and also includes items such as "premium adjustments" and "experience-related refunds" (26 U.S.C. 808(b)).

As the court of appeals correctly observed, the "policyholder dividend" provisions of Section 805 and 808 have "nothing to do with capital transactions altogether" (Pet. App. 25a). The express language of Section 808(a)(1), which defines a "policyholder dividend" as "any dividend or similar distribution to policyholders in their capacity as such," cannot be read to encompass the bilateral share exchange and redemption transactions involved in this case. The "term [dividend], as generally understood and used, refers to the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business, which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock." *Hellmich* v. *Hellman*, 276 U.S. 233, 237 (1928). See also *United States* v. *Davis*, 397 U.S. 301, 313 (1970) ("If a corporation distributes property as a simple dividend, the effect is to transfer the property from the company to its shareholders without a change in the relative

economic interests or rights of the stockholders."). The term, however, does *not* refer to a corporation's purchase of property from a shareholder for equivalent value. *Citizens Bank & Trust Co.* v. *United States*, 580 F.2d 442, 446 (Ct. Cl. 1978); *Commissioner* v. *Pope*, 239 F.2d 881 (1st Cir. 1957).

Because stock exchange and redemption transactions of the type engaged in by petitioners do not constitute a "dividend or similar distribution," they do not satisfy the standard for deductibility under Section 808(a). The court of appeals therefore properly rejected the extraordinary assertion advanced by petitioners that a mere corporate reorganization should yield an insurance company a $652 million income tax deduction (Pet. App. 25a).

2. Even though their claim is refuted by the plain text of Section 808(a), petitioners essentially ignore that provision. Petitioners instead contend (Pet. 13) that the stock exchange and redemption transactions involved in this case constitute a "policyholder dividend" because they are the culmination of petitioners' "experience" in the insurance business and therefore fit within the literal terms of Section 808(b)(1). See 26 U.S.C. 808(b)(1) (defining "policyholder dividend" to include qualified dividend payments based upon "the experience of the company"). That facile attempt to latch upon one word in a complex set of tax provisions was properly rejected by the court of appeals as an "attempt to sweep the language of § 808(a) under the table" (Pet. App. 19a).[8] As the court explained,

---

[8] The court of appeals correctly rejected petitioners' contention (Pet. 26-28) that the legislative history and underlying purpose of Section 808 support their claimed deduction. As the court of appeals observed (Pet. App. 35a), "[n]othing UNUM

"[b]asic canons of statutory construction require it to consider the language of § 808(a) in construing § 808(b)" (*id.* at 25a, citing *United States National Bank of Oregon* v. *Independent Insurance Agents of America, Inc.*, 508 U.S. 439, 455 (1993)).[9] As the court stated in rejecting petitioners' implausible reading of the statute (*id.* at 33a):

> Had Congress wanted to provide insurance companies with a "policyholder dividend" deduction for any distribution to policyholders not fixed in the contract, it could simply have defined "policyholder dividend" as referring to "any distribution." It would not have limited the definition to "dividends or similar distributions" and then left it to the insurance industry to discover massive deductions in the shadows of the statute.

"[T]he plain meaning of § 808 works against, and not for, UNUM" (*ibid.*).

3. Petitioners err in contending that the question presented in this case "is one on which conflict and confusion exist" (Pet. 13). The cases cited by petitioners (Pet. 14) that advert to an "expansive"

---

cites supports the proposition that Congress intended the term 'policyholder dividends' to encompass value-for-value exchanges occurring during a corporate reorganization."

[9] Petitioners err in contending (Pet. 19-26) that the decision in this case conflicts with settled norms of statutory construction. The court of appeals followed well-established principles of statutory construction by examining the statute as a whole and placing the provisions in their proper context. See *Conroy* v. *Aniskoff*, 507 U.S. 511, 515-516 (1993). By contrast, petitioners attempt to divorce Section 808(b)(1) from the other parts of the same statute and thus violate the settled rule that statutory phrases are not to be construed in isolation. See *United States* v. *Morton*, 467 U.S. 822, 828 (1984).

definition of "policyholder dividends" under provisions of the former Life Insurance Company Tax Act do not address value-for-value exchanges made in the context of a demutualization.[10] Instead, those cases concern unilateral actions of insurance companies to distribute surplus to shareholders in the ordinary course of business. As petitioners acknowledge indirectly (Pet. 11), the issue addressed by the court of appeals in the present case is one of first impression—in no prior case has an insurance company sought to obtain a deduction for its entire net worth in connection with a corporate reorganization.[11]

4. Petitioners mistakenly assert (Pet. 18) that the government has adopted "conflicting positions" in interpreting and applying the applicable provisions of the Code. As the court of appeals recognized (Pet.

---

[10] Petitioners' reliance (Pet. 15) on former Treas. Reg. 1.811-2(a) (1961) is similarly flawed. That regulation did not address value-for-value exchanges between insurance companies and their policyholders; nor did it address transactions that alter the capital structure of an insurance company.

[11] Petitioners erroneously assert, albeit only in a footnote (Pet. 14 n.8), that the decision in this case is "at odds" with *Ruocco* v. *Bateman, Eichler, Hill, Richards, Inc.*, 903 F.2d 1232 (9th Cir.), cert. denied, 498 U.S. 899 (1990). That case concerned a provision of the California Insurance Code. The Ninth Circuit did not construe Section 808 in *Ruocco*. See 903 F.2d at 1236-1237. Its decision in that case therefore cannot be said to be in conflict with, or "at odds" with, any decision (such as the present case) involving that provision of the Internal Revenue Code. The possibility that stock transferred to policyholders in a demutualization could be characterized as a "dividend" for purposes of the California Insurance Code (or any other state law) is obviously irrelevant to this federal tax case. See *Burnet* v. *Harmel*, 287 U.S. 103, 110 (1932).

App. 11a-13a), the Service has consistently treated this transaction as a tax-free exchange that creates neither income for the shareholders nor a deduction for the insurer. By contrast, petitioners *have* taken conflicting positions in this case. As the court of appeals noted, petitioners originally "acknowledged that its demutualization was a capital transaction subject to general corporate tax law when it submitted its * * * request to the IRS for a private letter ruling regarding whether the conversion would be entitled to tax-free treatment" (*id.* at 21a n.8). It was only later, after obtaining a favorable ruling, that petitioners reversed ground to contend that the transactions represented dividends, which would give rise to a $652 million deduction for the company and an equivalent amount of income to its shareholders.

5. Petitioners err in relying (Pet. 23) on 26 U.S.C. 316. Section 316(a) generally defines a corporate dividend as "any distribution of property made by a corporation to its shareholders * * * out of its earnings and profits" (26 U.S.C. 316(a)). Section 316(b) then further provides that "[t]he definition in subsection (a) shall not apply to the term 'dividend' as used in subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such" (26 U.S.C. 316(b)). Section 316(b) was enacted because "policyholder dividends" (unlike corporate dividends) are not made solely from net income; instead, they include items such as premium adjustments and experience-related refunds that represent price rebates rather than distributions of net income. See 26 U.S.C. 808(b). As the court of appeals correctly recognized, the fact that a "policyholder dividend" is not necessarily distributed from net income does not mean that the term "encompasses any distri-

bution to policyholders regardless of its context or purpose" (Pet. App. 27a).[12] As the district court similarly stated in rejecting petitioners' reliance on Section 316(b) (Pet. App. 50a n.10):

> § 316(b)(1) *cannot* prohibit the application of other sources of law that help define "dividend" without thereby reading the term (and, consequently, "or similar") entirely out of the § 808(a) definition of "policyholder dividend." To read "dividend" as limitless in scope in the phrase "any dividend or similar distribution" is to read the phrase instead as "any distribution."

6. Contrary to petitioners' assertion (Pet. 21-22), the court of appeals properly relied on *Colonial American Life Insurance Co.* v. *Commissioner*, 491 U.S. 244 (1989), in reaching its decision in this case. The issue in *Colonial American* was whether ceding commissions paid by a reinsurance company to a direct insurer under a contract for indemnity reinsurance are fully deductible in the year tendered or must be amortized over the anticipated life of the reinsurance agreements. 491 U.S. at 246. The Court noted that there is a general tax principle that "amounts expended to acquire an asset with an income-producing life extending substantially beyond

---

[12] Petitioners also err in relying on the general statement in *Republic National Life Insurance Co.* v. *United States*, 594 F.2d 530, 532 (5th Cir. 1979), that the term "policyholder dividends" in Section 808 includes more than classic corporate dividends. As the court of appeals correctly observed (Pet. App. 27a n.13) in this case, the statement of the Fifth Circuit in *Republic National* was not directed at value-for-value stock exchanges and redemptions occurring during a corporate reorganization.

the taxable year of acquisition must be capitalized and amortized over the useful life of the asset." *Id.* at 252-253. The Court held that that general tax principle controlled the outcome of the case "absent some specific statutory provision indicating that ceding commissions for indemnity insurance are an exception to the general rule for which Congress has authorized current deduction." *Id.* at 253. After concluding that there was no specific provision in Subchapter L that provided for the claimed deduction, the Court applied the general corporate tax rule to that case. *Id.* at 260.

The reasoning applied by this Court in *Colonial American* is directly applicable here. As the court of appeals concluded (Pet. App. 28a-31a), nothing in the provisions of Sections 805 and 808 that authorize a deduction for dividends and similar distributions by insurers also authorizes a deduction for capital transactions by insurers involving value-for-value exchanges and redemptions of corporate stock. The general corporate tax rule that denies a deduction for such exchanges (26 U.S.C. 162(k)) therefore controls in this case. Congress simply has not authorized the extraordinary tax bonanza for reorganizing insurers that petitioners seek.

7. Petitioners are not correct in asserting (Pet. 11-12) that certiorari should be granted in this case even in the absence of a conflict among the circuits. It is true, as petitioners point out (*ibid.*), that enormous tax consequences would ensue if petitioners' extraordinary contentions were adopted. But there is no precedent for petitioners' implicit suggestion that a taxpayer's bold misapplication of the Internal Revenue Code is somehow thereby made more worthy of review by this Court.

The cases cited by petitioners are plainly not on point. In cases such as *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132 (1989), and *United States* v. *Hill*, 506 U.S. 546 (1993), this Court reviewed decisions of the United States Court of Appeals for the Federal Circuit that were adverse to the government. Because that circuit has national jurisdiction over appeals in tax refund suits filed in the Court of Federal Claims—and every similarly situated taxpayer can therefore obtain review of tax claims in that circuit—the decisions of that circuit that are adverse to the government are nationally effective in the absence of review by this Court. It is for that reason that the United States sometimes requests review of decisions of the Federal Circuit in the absence of a conflict, and it is for that reason that this Court sometimes grants review of such cases.

That situation, however, obviously does not apply in this case. The decision of the court of appeals is not directly binding on any other taxpayer. It determines only the law applicable in the First Circuit. Moreover, even other insurance companies located in the First Circuit are not bound by this decision, for they can bring the issue to the Federal Circuit by commencing a refund action in the Court of Federal Claims. There is thus no conflict among the circuits or other reason to warrant review by this Court in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
DAVID I. PINCUS
EDWARD T. PERELMUTER
Attorneys

JUNE 1998

Supreme Court, U.S.
FILED
JUN 30 1998
CLERK

No. 97-1679

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

UNUM CORPORATION and
UNUM LIFE INSURANCE COMPANY OF AMERICA,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

REPLY BRIEF FOR PETITIONER

BARBARA H. FUREY
BARRY W. LARMAN
UNUM CORPORATION and
UNUM LIFE INSURANCE
COMPANY OF AMERICA
2211 Congress Street
Portland, ME 04122
(207) 770-2211

JOHN G. ROBERTS, JR.*
GREGORY G. GARRE
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, DC 20004
(202) 637-5810

WILLIAM J. KAYATTA, JR.
JARED S. DES ROSIERS
PIERCE ATWOOD
One Monument Square
Portland, ME 04101
(207) 791-1100
Counsel for Petitioners

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

12 pp

TABLE OF AUTHORITIES

Cases: Page

Bennett v. *Spear*, 117 S. Ct. 1154 (1997) 5
Citizens Bank & Trust Co. v. *United States*, 580 F.2d 442 (Ct. Cl. 1978) 6
Colonial American Life Ins. Co. v. *Commissioner*, 491 U.S. 244 (1989) 8, 9
Commissioner v. *Pope*, 239 F.2d 881 (1st Cir. 1957) 6
Connecticut Nat'l Bank v. *Germain*, 503 U.S. 249 (1992) 7
Hellmich v. *Hellman*, 276 U.S. 233 (1928) 6
Republic Nat'l Life Ins. Co. v. *United States*, 594 F.2d 530 (5th Cir. 1979) 4, 5, 6
Salinas v. *United States*, 118 S. Ct. 469 (1997) 5
United States v. *Davis*, 397 U.S. 301 (1970) 6

Statutes:

26 U.S.C. § 316(b) 6
26 U.S.C. § 805(a)(3) 9
26 U.S.C. § 808 ..... 4, 9
26 U.S.C. § 808(a) 4, 7, 8
26 U.S.C. § 808(b) 4, 8
26 U.S.C. § 809(f)(4) 9

Legislative Materials:

S. Rep. No. 99-313 (1986) 9
105 Cong. Rec. 2571 (1959) (statement of Sen. Curtis) 5

Regulatory Materials:

Treas. Reg. § 1.811-2(a) (1961) 4, 6

Other:

S. Preston Ricardo, *The Deductibility of Policyholder Dividends*: UNUM Corp. *v.* United States, 50 Tax Law. 265 (1996) 3
Allan Sloan, *Deals*, Wash. Post, June 2, 1998 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

No. 97-1679

UNUM CORPORATION and
UNUM LIFE INSURANCE COMPANY OF AMERICA,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

---

REPLY BRIEF FOR PETITIONER

---

1. The government acknowledges (Opp. 16) that the question presented has "enormous tax consequences," and it does. As we explained in the petition (pp. 11-13), and as the Court of Appeals recognized below, whether distributions made to policyholders as part of a demutualization are deductible "policyholder dividends" within the meaning of Subchapter L of the Code has "great financial consequences" for the insurance industry as well as the "public fisc." Pet. App. 2a. This past February the Nation's largest mutual insurer, Prudential, announced its intention to demutualize, *see* Pet. 5 n.2; since the petition was filed, yet another major mutual insurer, John Hancock, announced it was following suit, leading one observer to remark that the mutual insurance industry, while typically "excruciatingly dull," has become "interesting"—

"[e]xciting, even." Allan Sloan, *Deals*, Wash. Post, June 2, 1998, at C3.

The question whether such policyholder distributions are deductible not only is undeniably important and certain to recur, but is cleanly presented by this case, in which the First Circuit decision squarely answering that question in the negative has resulted in the imposition of at least a $77 million tax burden on UNUM. *See* Pet. 11 & n.6. As we explained in the petition (p. 12), this Court has granted certiorari in numerous cases presenting tax issues of such magnitude, even in the absence of an entrenched circuit conflict. In response, the government says these cases are "not on point" because they involved review of decisions that "were adverse to the government." Opp. 17. But this Court has never suggested that its certiorari docket operates in such a one-way fashion. Where, as here, an important federal tax ruling is plainly —or even arguably—contrary to Congress' intent, certiorari is just as appropriate when the ruling imposes an unintended burden on the taxpayer, as when it adversely affects the tax collector.[1]

Given the hundreds of millions of dollars of potential tax liability implicated by the question presented as the Nation's major mutual insurers race towards demutualiza-

---

[1] The government's suggestion that acceptance of UNUM's position would result in a "tax bonanza" (Opp. 16) for mutual insurers reflects a fundamental misunderstanding of the tax rules governing the flow of capital through mutual insurers as opposed to stock companies. Mutual insurers—unlike stock companies—must include in their taxable income capital contributions or their equivalent (including redundant premiums) when received. *See* Pet. 5-6. As a result, far from granting mutual insurers a "tax bonanza," recognizing that such capital is deductible when it is distributed back to policyholders as part of a demutualization would simply insure that mutual insurers are not saddled with an enormous tax *burden* not imposed upon stock companies—*i.e.*, being taxed on both the receipt *and* return of capital (or its equivalent)—and, instead, are accorded tax treatment equal to that of stock companies. *See* Pet. 27.

tion, as well as the need for certainty on federal tax issues of such enormity, there is ample reason to grant certiorari on the basis of the undeniable importance of this "landmark case" alone. S. Preston Ricardo, *The Deductibility of Policyholder Dividends:* UNUM Corp. *v.* United States, 50 Tax Law. 265 (1996) (quotation omitted); *see* Pet. 11-13. But as we explained in the petition (pp. 13-19), the question presented is not only undeniably important, it is the subject of conflict and confusion, too.

2a. That confusion is highlighted by the conflicting positions that the Internal Revenue Service itself has taken on the question presented. The government astonishingly asserts (Opp. 14) that "the Service has consistently treated [policyholder distributions made during a demutualization] as a tax-free exchange that creates neither income for the shareholders nor a deduction for the insurer," but the Court of Appeals below was in fact on the mark when it stated that "[t]he IRS has not always held th[e] view [it now expouses] regarding the tax treatment of distributions from surplus made during a demutualization," and—while the government inexplicably neglects to acknowledge as much—that "the IRS [previously] took the view now advanced by UNUM that cash *distributions paid out of surplus to policyholders during the demutualization were policyholder dividends* * * *." Pet. App. 12a n.6 (emphasis added). The IRS's own flip-flop on the important question presented says a great deal about the confusion that surrounds this issue, as well as the serious arguments on both sides of it.[2]

---

[2] In an effort to redirect the Court's attention from the IRS's own about-face on the question presented, the government claims (Opp. 14) that UNUM has "taken conflicting positions in this case." It is true that, as we pointed out in the petition (p. 8), UNUM initially did not claim a deduction for the policyholder distributions at issue. But it is undisputed that UNUM properly amended its tax return—based on its further consideration of the federal tax question presented—to claim such a deduction. UNUM's indecision on this important issue was in part a product of the uncertainty currently surrounding the availability of the policy-

b. The government also refuses to acknowledge the basic conflict between the First Circuit's "strict[]" (Pet. App. 47a) construction of the statutory definition of the term "policyholder dividend" and the "expansive," plain meaning construction of that same term by the Fifth Circuit in *Republic National Life Insurance Co.* v. *United States*, 594 F.2d 530, 532 (5th Cir. 1979), and by the Treasury Department in Treas. Reg. § 1.811-2(a) (1961) ("In general, *any* payment not fixed in the contract * * * shall be treated as a dividend to policyholders.") (emphasis added). *See* Pet. 13-16. According to the government, the fact that other federal circuits and the Treasury Department have—quite unlike the First Circuit below—taken at face value the broad definition of the term "policyholder dividend" is of no moment, because the cases cited do not specifically apply the term to distributions "made in the context of a demutualization." Opp. 13; *see id.* 13 n.10, 15 n.12. But as we explained in the petition (pp. 20-21), any objective, plain meaning construction of the open-ended language Congress used in Section 808 to define "policyholder dividend" should result in the conclusion that the distributions at issue are deductible. The government's narrow emphasis on "context" is no answer to the outcome-determinative effect that a strict versus plain meaning construction of the term "policyholder dividend" has on the resolution of the important question presented by this case.

"Policyholder dividend" is defined to include "*any* dividend or similar distribution," and "*any* amount * * * not fixed in the contract." 26 U.S.C. § 808(a), (b) (emphases added). Congress in 1984 specifically added the word "any" to the general definition in Section 808(a) to underscore the term's breadth. *See* Pet. 27. That should eliminate any doubt as to the term's intended reach, for, as this Court has recently emphasized, Congress' use of

---

holder dividends deduction in the demutualization context, and thus, to the extent it is relevant here, simply underscores the need for this Court's review.

the word "any" "undercuts the attempt to impose [a] narrowing construction," *Salinas* v. *United States*, 118 S. Ct. 469, 473 (1997), and should be taken at "face value," even if it gives a term "remarkable breadth." *Bennett* v. *Spear*, 117 S. Ct. 1154, 1162 (1997). The government's basic response seems to be that Congress could not possibly have meant what it said because the type of distributions at issue in this case do not fit the mold of the typical *corporate* dividend. *See* Opp. 10-11. But as the Fifth Circuit specifically recognized in *Republic National*, Subchapter L's "expansive" definition of the term "policyholder dividend" was "intended to include *more* than just classic dividends." 594 F.2d at 532 (emphasis added). This makes perfect sense because, as we explained in the petition (pp. 5-6), the flow of capital through stock companies is taxed under an entirely different scheme than the one established in Subchapter L for insurers. *See* note 1, *supra*.

While it is unnecessary—at least under a plain-meaning construction such as the Fifth Circuit's in *Republic National*—to go beyond the text of the statutory definition of the term "policyholder dividend" to reach this conclusion, there is ample indicia of congressional intent to support it. *See* Pet. 25-26. Thus, for example, the principal drafter of the statutory definition of "policyholder dividend" stated that "the word 'dividend' in life insurance companies has a *different* connotation than we would use in the investment field." 105 Cong. Rec. 2571 (1959) (statement of Sen. Curtis; emphasis added). *See Republic National*, 594 F.2d at 536 (congressional "debates reflect an understanding that 'dividend' as used in the insurance industry is a *term of art* which means almost *any* payment not derived solely from premium income") (quotation omitted; emphases added); Pet. 25 (dictionary definition). To cement the point, Congress specifically declared in Subchapter C that the definition of "dividend" for general corporate matters "shall *not* apply to the term 'dividend' as used in subchapter L in any case where the

reference is to dividends of insurance companies paid to policyholders as such." 26 U.S.C. § 316(b) (emphasis added).[3] The government—like the First Circuit—simply refuses to take Congress at its word.

The context in which the Fifth Circuit adopted its plain-meaning construction of the term "policyholder dividend" in *Republic National* is different in one important respect from that in which the First Circuit adopted its strict construction below: the Fifth Circuit did so at the urging of the *government* which—consistent with Treas. Reg. § 1.811-2(a) (1961)—argued that the term "policyholder dividend" should be "expansive[ly]" construed. 594 F.2d at 532. As we explained in the petition (pp. 15-16), under the tax scheme in effect at the time *Republic National* was decided (1979) that position was generally favorable to the government, since policyholder dividends were deductible only in part. Congress changed this scheme in 1984, making policyholder dividends deductible almost in their entirety. And yet, while Congress at the same time *expanded* the definition of the term "policyholder dividend," *see* Pet. 16, the government after the 1984 amendments took the opposite view that the term "policyholder dividend" should be construed narrowly. The government may have valid institutional reasons for flipping positions on the meaning of the term "policyholder dividend" in light of the suddenly unfavorable tax consequences of its previous, plain-meaning interpretation of that same term, but it may not maintain with a straight

---

[3] Each of the cases cited by the government for the proposition that the distributions at issue in this case are not "policyholder dividends" within the meaning of Subchapter L involve application of the statutory definition of the classic *corporate* dividend for purposes of Subchapter *C*. *See* Opp. 10-11 (citing *Hellmich* v. *Hellman*, 276 U.S. 233, 237 (1928); *United States* v. *Davis*, 397 U.S. 301, 313 (1970); *Citizens Bank & Trust Co.* v. *United States*, 580 F.2d 442, 446 (Ct. Cl. 1978); *Commissioner* v. *Pope*, 239 F.2d 881 (1st Cir. 1957)).

face that its position on the meaning of the term has been "consistent[]." Opp. 14.

c. The government relegates to a footnote (Opp. 12 n.9) its effort to reconcile the First Circuit decision below with the settled norms of statutory construction adopted by this Court. Even then, it chooses not to respond to the specific conflicts identified in the petition (pp. 19-28), but instead simply states in blanket fashion that the First Circuit decision accords with the principles that a "statute [should be viewed] as a whole and [by] placing the provisions [at issue] in their proper context." Opp. 12 n.9. We agree that the statute should be read against this backdrop, which is why the different schemes established by Subchapters C and L for taxing the flow of capital through stock as opposed to insurance companies—which the government refuses to acknowledge—are key to answering the question presented. But the government fails to come to grips with the "one, cardinal canon before all others"—"that courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992); *see* Pet. 19-21. That canon is especially important in construing the federal tax code, where the need for certainty and predictability—especially among businesses that must continuously evaluate the fiscal implications of their actions—is so great.

3. On the merits, the government astonishingly asserts that UNUM's claim is "refuted" by Section 808(a), a provision which it says we "essentially ignore." Opp. 11. As the petition (pp. 13, 16, 27, 28) alone should make clear, however, we do not ignore Section 808(a). We embrace it. That provision states in open-ended fashion that "the term 'policyholder dividend' means *any* dividend or similar distribution to policyholders in their capacity as such." 26 U.S.C. § 808(a) (emphasis added). Congress, as noted, added the word "any" to Section 808(a) when it amended the statute in 1984, putting an exclama-

tion point on the term's breadth. *See* Pet. 27; *supra* at 4. The fact that the distributions at issue in this case *also* plainly meet the more specific definition found in Section 808(b), *see* Pet. 13, should resolve any doubt as to whether they fit within the general definition in Section 808(a).

In construing Section 808(a), the government's basic hang up seems to be the word "dividend." Here, the government commits the same basic error as the Court of Appeals: it assumes that Section 808's definition of "policyholder dividend" does not reach distributions made as part of a demutualization because, the government says, such distributions are unlike ordinary *corporate* dividends. *See* Opp. 10-11, 14-15. In other words, when it comes to construing the word "dividend," the government takes the term out of the insurance context in which it resides (*i.e.*, Subchapter L) and ascribes to it the meaning it has in the general corporate context (*i.e.*, Subchapter C). *See* Opp. 10-11 (relying solely on general corporate cases to define "dividend"). As explained, however, the government's analogy to general corporate tax principles is inapt in light of the fundamental differences in the manner in which the tax code treats the flow of capital through stock versus insurance companies. Indeed, if the analogy were apt, then mutual insurers would not be required to include redundant premiums in their taxable income in the first place (since corporations are not required to include the equivalent capital contributions in their taxable income, *see* Pet. 5-6), and policyholder dividends would not be deductible at all—even though Subchapter L plainly says they are.

The government also defends the First Circuit's misplaced reliance on *Colonial American Life Insurance Co.* v. *Commissioner*, 491 U.S. 244 (1989). *See* Opp. 15-16. As we explained in the petition (pp. 21-22), *Colonial American* does not even mention Subchapter C (or any

of its provisions), let alone purport to "address[] the relationship between Subchapter C and Subchapter L," Pet. App. 16a, as the Court of Appeals and now the government claim. More important, the whole premise for the First Circuit's and government's reliance on *Colonial American*—"that there [is] no specific provision in Subchapter L that provide[s] for the claimed deduction," Opp. 16—is mistaken. Subchapter L not only speaks to the matter in Sections 805 and 808 but—taking Congress' word at face value—specifically allows insurers to deduct distributions made to policyholders as part of a demutualization. 26 U.S.C. §§ 805(a)(3), 808, 809(f)(4); Pet. 13. Accordingly, even assuming *Colonial American* may be elevated into the "rule" (Pet. App. 16a) formulated for the first time by the Court of Appeals below, it is of no avail to the government in seeking to deny UNUM the deduction to which it is specifically entitled under Subchapter L.[4]

* * * *

For the foregoing reasons, and those in the petition, the petition for a writ of certiorari should be granted.

---

[4] The government's reliance (Opp. 8) on Section 162(k) is also misplaced. That provision was enacted in the context of Congress' concern that *stock* corporations—which, unlike mutual insurers, are not taxed on the receipt of capital, and so do not enjoy a deduction for its return to investors—were trying to find ways to deduct payments made in re-purchasing stock from stockholders. *See* S. Rep. No. 99-313, at 223 (1986) ("The committee understands that some corporate taxpayers are taking the position that expenditures incurred to repurchase stock from stockholders to prevent a hostile takeover of the corporation by such shareholders—so-called 'greenmail' payments—are deductible business expenses.") It has no application to the policyholder distributions at issue in this case, which are subject to the special rules set forth in Subchapter L.

Respectfully submitted,

BARBARA H. FUREY
BARRY W. LARMAN
UNUM CORPORATION and
UNUM LIFE INSURANCE
COMPANY OF AMERICA
2211 Congress Street
Portland, ME 04122
(207) 770-2211

JOHN G. ROBERTS, JR.*
GREGORY G. GARRE
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, DC 20004
(202) 637-5810

WILLIAM J. KAYATTA, JR.
JARED S. DES ROSIERS
PIERCE ATWOOD
One Monument Square
Portland, ME 04101
(207) 791-1100
Counsel for Petitioners

* Counsel of Record